



COWAY (021240)

2Q18 Review: Earnings Met Consensus, but New Rental Sales Growth Bit Disappointing

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Shinay Park Analyst
Retail, Cosmetics

Jaewon Song RA
82-2-6114-2972

82-2-6114-2930 shinay.park@kbfq.com jaewon.song@kbfq.com

2Q18 consolidated OR up 9% YoY, OP up 7% YoY meeting consensus, but new rental sales fell 2% YoY

2Q18 earnings met consensus with consolidated OR coming in at KRW678.1bn (up 9% YoY) and OP at KRW129.3bn (up 7% YoY). Stand-alone OR reached KRW595.8bn (up 4% YoY) and OP stood at KRW119.9bn (down 4% YoY), while a changed sales mix and increasing advertisement costs caused OPM to drop 1.7%p. ① Rental OR grew 1%, but new rental sales (net orders) decreased 2% YoY to come in lower than expected. The cancellation rate increased 1.1% (effects of new products) resulting in net rental account growth of only 74,000 accounts (previous estimate of 93,000 accounts). ② Home care OR grew 35%, but membership and lump-sum payment OR each dropped 15%, 6%. ③ Four overseas environmental appliance subsidiaries' total OR and OP came in at KRW112.9bn (up 63% YoY) and KRW15.2bn (up 485% YoY), respectively. The Malaysian subsidiary's OR grew 87% and OPM improved 11%p, while the growth rate of accounts reached 47%. The high growth of OR and OP was due to accounting factors stemming from the launch of financial lease product sales (= rental period and mandatory usage period of 7 years).

2018 consolidated OR expected to rise 8% YoY, OP to grow 10% YoY

2018 consolidated OR and OP are forecast at KRW2.7tr (up 8% YoY) and KRW519.5bn (up 10% YoY), respectively. Annual net increase in accounts is expected to reach 261,000 accounts with new rental sales of 1.5mn units and a monthly average cancellation rate of 1.05%. Coway launched direct-flow water purifiers with RO (reverse osmosis) membrane filters and apparel refreshing machines. The apparel refreshing machines were first sold under lump-sum payment plans when they were first launched, but starting in Aug, the appliances are also available for rent. The effects of new product sales are expected to materialize in 2H18.

Buy maintain

Target Price (maintain)	KRW110,000
Upside/Downside	17.3%
Current price (Jul 31)	KRW93,800
Consensus Target Price	KRW112,000
Market cap	USD6.2bn

Trading Data

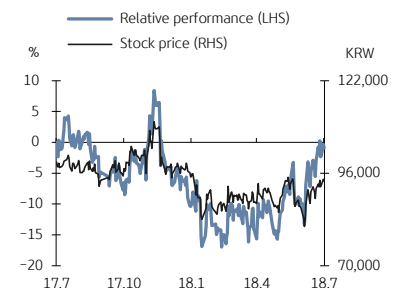
Free float	70.4%
Avg T/O Val (3M, KRWbn)	14.2
Foreign ownership	60.2%
Major shareholders	Coway Holdings, Inc. and 6 others 27.3%
	GIC Private Limited 7.4%

Performance

(%)	1M	3M	6M	12M
Absolute	8.3	7.2	-1.5	-5.3
Relative	9.8	17.5	10.2	-0.9

Forecast earnings & valuation

FY-end	2017A	2018E	2019E	2020E
OR (KRWbn)	2,517	2,719	2,947	3,150
OP (KRWbn)	473	520	553	589
NP to parent (KRWbn)	326	367	389	416
EPS (KRW)	4,328	4,970	5,276	5,643
EPS Growth (%)	36.7	14.8	6.2	7.0
PER (x)	22.6	18.9	17.8	16.6
EV/EBITDA (x)	11.0	9.3	8.7	8.3
PBR (x)	7.4	6.2	5.6	5.0
ROE (%)	30.1	35.0	33.1	31.8
Div. Yield (%)	3.3	3.6	3.8	4.1

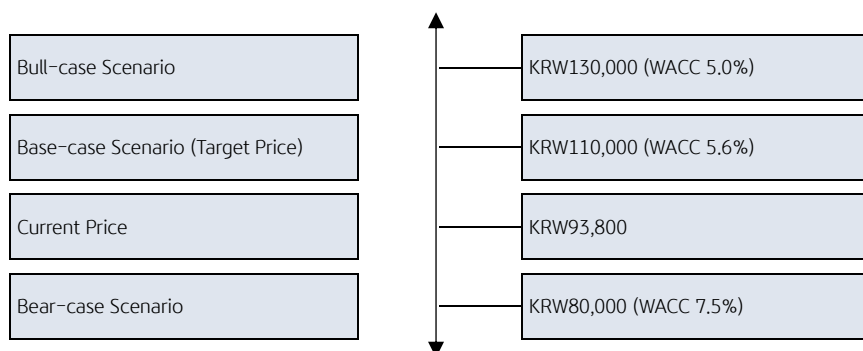


Source: COWAY, KB Securities estimates

Keep Buy and target price of KRW110,000. Strong sales of new rental products and recovery of growth need to be verified

We maintain buy with a target price of KRW110,000 (change in earnings estimates is less than 1%). The key investment points for Coway continue to be: ① differentiated products and door-to-door sales, ② a high dividend yield (estimated at 3.6% in 2018), and ③ overseas growth momentum. However concerns also exist over sluggish new rental sales, a slowdown in profitability improvement, and growing market shares of latecomers. For a meaningful increase in the share price, a recovery in net account growth via the management of cancellation rates is needed first as well as sound sales of new rental products after 3Q18.

Investment opinion and risks



Base-case Scenario: Catalysts

- 1) Stable domestic net rental account growth
- 2) High growth at overseas businesses, including Malaysia

Bull-case Scenario: Upside risks

- 1) Strong sales of new rental products, including apparel refreshers
- 2) Higher-than-expected earnings at overseas units

Bear-case Scenario: Downside risks

- 1) Weak domestic net rental account growth due to intensifying competition
- 2) Shift in business and dividend policies following change in major shareholder

Adjusted earnings estimates

(KRWbn, %)	Before		After		Change	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	2,715.1	2,935.8	2,719.2	2,947.4	0.2	0.4
OP	519.9	559.8	519.5	553.1	-0.1	-1.2
NP to parent	366.9	394.1	366.8	389.4	-0.0	-1.2

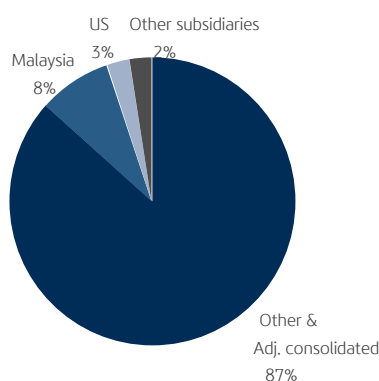
Source: KB Securities estimates

Difference vs. Consensus

(KRWbn, %)	KB est.		Consensus		Contrast	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	2,719.2	2,947.4	2,688.6	2,865.2	1.1	2.9
OP	519.5	553.1	516.8	563.2	0.5	-1.8
NP to parent	366.8	389.4	370.3	406.6	-0.9	-4.2

Source: FnGuide, KB Securities estimates

OR composition (%): 2017 basis



Source: Company data, KB Securities

Peer group comparison

(USDbn, X, %)	Market cap.	PER		PBR		EV/EBITDA		ROE		Dividend Yield	
		2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E
Cuckoo Homesys	0.9	22.1	17.3	2.4	2.2	10.0	7.5	16.7	19.1	1.7	2.2
Lock & Lock	1.2	21.2	18.3	1.7	1.7	13.7	11.4	9.9	11.2	1.2	1.7
RINNAI CORP	5.1	23.1	21.8	1.8	1.7	8.9	8.2	8.1	7.9	0.9	0.9
Whirlpool	11.0	10.0	8.8	2.6	2.5	6.8	6.0	23.4	29.2	3.0	3.3

Source: Bloomberg, KB Securities

Valuation and target price calculation

- 1) Valuation method:
DCF valuation
- 2) Target price calculation:
WACC 5.8% (COE 7.9%, COD 1.8%, 2015~2016 avg. Beta of 0.7), applied terminal growth rate (after 2024) of 0.5%
- 3) Upside ~ downside of target price:
KRW130,000 ~ KRW80,000
- 4) Valuation upon arriving at target price:
2018E Implied PER of 22x, PBR of 7x

Earnings sensitivity analysis

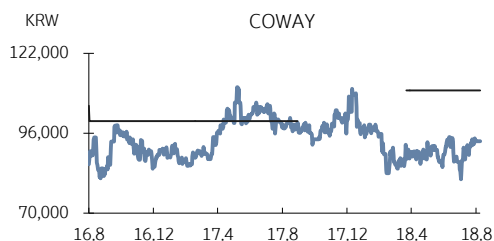
(%)	EPS change	
	2018E	2019E
1%p rise in interest rate	-0.9	-0.7
1% rise in FX rate	+0.3	+0.3

Profit & Loss						Statement of financial position					
(KRWbn)	2016A	2017A	2018E	2019E	2020E	(KRWbn)	2016A	2017A	2018E	2019E	2020E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	2,376	2,517	2,719	2,947	3,150	Total assets	1,968	2,159	2,191	2,261	2,384
Cost of sales	812	798	859	925	982	Current assets	733	791	868	901	994
Gross profit	1,564	1,718	1,861	2,023	2,168	Cash and cash equivalents	66	110	144	128	166
SG&A expenses	1,225	1,246	1,341	1,469	1,579	Current financial assets	75	60	54	51	49
Operating profit	339	473	520	553	589	Trade receivables	293	315	346	381	419
EBITDA	572	708	785	827	869	Inventories	70	75	80	86	92
Non-operating accounts	-15	-33	-22	-20	-19	Other current assets	228	232	243	255	268
Interest income	1	1	3	2	2	Non-current assets	1,235	1,367	1,323	1,359	1,390
Interest expenses	6	12	17	15	13	Investment assets	89	89	89	89	89
Profit on equity method	0	0	0	0	0	Property, plant and equipment	669	712	755	790	820
Net other non-operating income	-10	-22	-7	-8	-8	Intangible assets	183	184	184	184	185
Profit before tax	324	440	498	533	570	Other non-current assets	292	381	295	295	295
Income tax expense	80	114	131	144	154	Total liabilities	784	1,177	1,076	1,024	1,001
Net profit	243	326	366	389	416	Current liabilities	735	1,125	1,020	971	951
NP to parent	244	326	367	389	416	Trade payables	59	54	56	57	59
Adj. net profit	244	326	367	389	416	Short-term financial liabilities	340	670	536	482	458
						Other current liabilities	317	361	397	401	405
						Non-current liabilities	49	52	55	53	50
						Non-current financial liabilities	12	12	10	8	6
						Other non-current liabilities	25	22	27	27	27
						Total equity	1,183	982	1,115	1,237	1,382
						Issued capital	41	41	41	41	41
						Share premium	127	129	129	129	129
						Other equity interest	-159	-146	-44	-44	-44
						Accumulated other comprehensive income	-6	-5	0	0	0
						Retained earnings	1,180	963	989	1,111	1,257
						Equity attributable to owners of parent	1,183	982	1,115	1,237	1,383
						Non-controlling Interests	1	0	0	-1	-1
Operating Statistics & Ratios						Main Ratio					
(%)	2016A	2017A	2018E	2019E	2020E	(X, %, KRW)	2016A	2017A	2018E	2019E	2020E
OR growth	2.6	5.9	8.0	8.4	6.9	Multiples					
OP growth	-26.9	39.5	9.9	6.5	6.5	PER	27.9	22.6	18.9	17.8	16.6
EBITDA growth	-17.2	23.8	10.9	5.3	5.0	PBR	5.7	7.4	6.2	5.6	5.0
NP growth of parent	-29.0	33.8	12.5	6.2	7.0	PSR	2.9	2.9	2.5	2.3	2.2
GP margin	65.8	68.3	68.4	68.6	68.8	EV/EBITDA	12.2	11.0	9.3	8.7	8.3
OP margin	14.3	18.8	19.1	18.8	18.7	EV/EBIT	20.5	16.5	14.0	13.1	12.2
EBITDA margin	24.1	28.1	28.9	28.1	27.6	Dividend yield, ordinary (%)	3.6	3.3	3.6	3.8	4.1
EBT margin	13.6	17.5	18.3	18.1	18.1	EPS	3,167	4,328	4,970	5,276	5,643
NP margin	10.2	12.9	13.5	13.2	13.2	BPS	15,486	13,128	15,109	16,768	18,744
						SPS	30,890	33,402	36,845	39,938	42,690
						DPS (Annual, Ordnrly.)	3,200	3,200	3,400	3,600	3,800
						Cash dividends payout ratio (%)	96.3	71.2	66.9	66.7	65.8
						Operating performance					
						ROE	20.1	30.1	35.0	33.1	31.8
						ROA	13.0	15.8	16.9	17.5	17.9
						ROIC	20.6	25.6	27.3	28.2	28.4
						Financial structure (%)					
						Total liab./equity	66.3	119.8	96.5	82.8	72.5
						Net debt/equity	17.8	52.1	31.2	25.2	18.1
						Current Ratio	1.0	0.7	0.9	0.9	1.1
						Interest coverage (x)	55.5	38.3	30.2	38.1	44.0
						Activity ratios	0	0	0	0	0
						Asset turnover (x)	1.3	1.2	1.3	1.3	1.4
						Receivables turnover (x)	8.7	8.3	8.2	8.1	7.9
						Inventory turnover (x)	33.9	34.7	35.1	35.6	35.5

Source: COWAY, KB Securities estimates

Disclosures

Rating and Target Price Changes (Share price —, Target Price —)



COWAY (021240)

Date	Rating	Target Price (KRW)	Differential (%)	
			Avg.	Max/Min
16-08-03	Buy	100,000	-10.10	-1.40
17-02-03	6 month later	100,000	-5.16	11.00
17-05-24	Hold	100,000	-0.38	-7.70
17-11-24	6 month later	100,000	1.17	0.00
18-03-21	Buy	110,000		

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Proportion of investment rating (as of June 30, 2018)

Buy	Hold	Sell
74.2	25.8	-

* Note: Based on reports presented with investment ratings over the past one year

Classification and Standards for Investment Rating

Investment Rating for Company

(based on estimation of six-month absolute returns)

Buy: +15% or beyond	Hold: Between 15% and -15%	Sell: -15% or beyond
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Note: KB Securities's classification of investment ratings has shifted from four stages (Strong BUY, BUY, Marketperform, Underperform) to three stages (Buy, Hold, Sell) based on Korean reports since February 23, 2017.

Investment Rating for Industry

(based on estimation of six-month absolute returns)

Positive:	Neutral:	Negative:
To outperform market	To match market performance	To underperform market

Notes: The industry rating system of KB Securities has shifted from (Overweight, Neutral, Underweight) to (Positive, Neutral, Negative) as of Jun 28, 2017

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