# Woongifin Coway (021240) 

## BUY (maintain)



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## Briefing on Visit to China Subsidiary

## Earnings visibility increased after restructuring

Woongjin Coway's wholly owned China subsidiary is engaged in the cosmetics and home appliance businesses. After aggressive investments through 2009, the company was partially restructured (with sales outlets realigned, etc.) in 2010-11. In 2012, the company should exhibit stable top-line growth and a sound profit structure thanks to the benefits of restructuring and economies of scale.

## Cosmetics and home appliances fared well in China in 2011

The China subsidiary's cosmetics and home appliance businesses continued to sustain stable growth in 2011 in line with guidance. It is estimated that cosmetics sales in yuan jumped $16 \% \mathrm{YoY}$, and the OP margin rose to over 24\%. Home appliance sales are estimated to have jumped $30 \%$ YoY due to brisk OEM sales of air purifiers through Philips.

## 2012 OR to jump 17\%YoY and OP 23\%YoY

2012 OR at the China subsidiary is projected to grow $17 \%$ YoY to CNY380mn and OP to swell $23 \% \mathrm{YoY}$ to CNY60mn (around KRW11bn) fueled by increasing revenue contribution from Beauty of Fermentation (new high-end brand), expansion of distribution channels to include home shopping, and a takeoff in the home appliance segment. The OP margin is also forecast to be maintained at over $24 \%$ thanks to completed restructuring over cosmetics brands.

## China subsidiary to account for 4\% of company's enterprise value

The China subsidiary is valued at KRW150bn based on our 2012 NP estimate (around KRW9.4bn) and a $20 \%$ discount to Chinese retailers' average PER of 20x. The value of the China subsidiary corresponds to around $5 \%$ of Woongin Coway's market cap of KRW2.9tr. The China subsidiary plans to enhance shareholder value by: 1) strengthening its grip over the cosmetics market; and 2) reducing losses in the home appliance segment.

| FY-end | 12/09A | 12/10A | 12/11F | 12/12F | 12/13F |
| :--- | ---: | ---: | ---: | ---: | ---: |
| (Reporting standard) | (GAAP-P) | (GAAP-P) | (IFRS-P) | (IFRS-P) | (IFRS-P) |
| OR (KRWbn) | $1,411.9$ | $1,519.1$ | $1,705.1$ | $1,868.0$ | $2,124.1$ |
| OP (KRWbn) | 204.3 | 228.8 | 240.6 | 274.9 | 308.3 |
| NP (KRWbn) | 153.3 | 177.0 | 185.2 | 210.9 | 237.6 |
| Parent NP (KRWbn) | 153.3 | 177.0 | 185.2 | 210.9 | 237.6 |
| EPS (KRWW) | 2,023 | 2,294 | 2,431 | 2,805 | 3,160 |
| Adj. EPS (KRW) | 2,023 | 2,294 | 2,431 | 2,805 | 3,160 |
| PER* (x) | $20.2-11.3$ | $20.0-13.6$ | $17.6-12.8$ | 13.6 | 12.1 |
| PBR (x) | 4.4 | 4.1 | 3.2 | 2.9 | 2.5 |
| EV/EBITDA (x) | 9.0 | 8.8 | 6.8 | 6.4 | 5.9 |
| Div. Yield (\%) | 2.6 | 2.6 | 3.1 | 3.1 | 3.3 |
| ROE (\%) | 24.0 | 24.5 | 21.3 | 22.6 | 22.2 |
| ROIC (\%) | 22.5 | 22.1 | 20.2 | 21.3 | 21.5 |

Source: Company data, Hyundai Securities

## Cosmetics and home appliances fared well in China in 2011

It is estimated that flagship cosmetics products recorded sales of CNY240mn (up 16\%YoY, equivalent to KRW41bn), OP of CNY59mn (down 12\%YoY, KRW10bn), and OP margin of $24 \%$ in 2011.

As for home appliances, water purifier sales are still sluggish as fixed costs remain burdensome, resulting in about CNY10mn in losses every year. However, thanks to brisk OEM sales of air purifiers through Philips from 2011, losses should contract from 2012. Air purifier sales are estimated to have grown $30 \% \mathrm{YoY}$ in 2011.

Meanwhile, the cosmetics OP margin is estimated to have fallen $7 \%$ pYoY to $24-25 \%$ in 2011. Due to a higher proportion of retailer (SASA, etc.) channels (from $1 \%$ in 2010 to $6 \%$ in 2011), sales promotional expenses increased and margins eroded.

Fig 1: 2011 cosmetics sales up 16\%YoY, OP margin at 24\%


Source: Company data, Hyundai Securities

Fig 2: Retailer channels expanding for cosmetics business in China


Source: Company data, Hyundai Securities

Cosmetics OP margin to be maintained at over 24\% after 2012

2012 earnings guidance for the China subsidiary will likely be provided in Feb, when the company's 4 Q 11 results are scheduled for release. Cosmetics revenues are projected to grow at least $16 \% \mathrm{YoY}$ in 2012, driven by: 1) increasing contribution from Beauty of Fermentation, a new high-end brand launched in May 2011; 2) additional launches of new products; and 3) the scheduled launch of home shopping-exclusive products and organic products that target the mass market.

Meanwhile, the cosmetics OP margin is forecast to be maintained at over $24 \%$, as the OR proportion of mid/high-end brands, including Cellart, Beauty of Fermentation, and Ruhen, is increasing ( $44 \%$ in 2011 from $37 \%$ in 2010), and the planned disposal of two, low-end brands (Hebeir, Meiqing) in 1H12 will enhance profit structure.

Revenues from the home appliance segment are also projected to expand $20 \%$ YoY thanks to solid air purifier sales via Philips, a business partner. Therefore, losses will diminish gradually driven by economies of scale and a shift in the operating structure, which previously incurred fixed costs.

Fig 3: OR proportion of mid/high-end cosmetics brands is increasing


[^0]| Profit \& Loss |  |  |  |  |  | Statement of financial position |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (KRWbn) (Reporting standard) | $\begin{array}{r} 12 / 09 A \\ (\text { GAAP-P) } \end{array}$ | $\begin{array}{r} 12 / 10 \mathrm{~A} \\ (\text { GAAP-P }) \end{array}$ | $\begin{aligned} & 12 / 11 \mathrm{~F} \\ & \text { (IFRS-P) } \end{aligned}$ | $\begin{aligned} & 12 / 12 \mathrm{~F} \\ & \text { (IFRS-P) } \end{aligned}$ | $\begin{aligned} & \text { 12/13F } \\ & \text { (IFRS-P) } \end{aligned}$ | (KRWbn) (Reporting standard) | $\begin{array}{r} 12 / 09 A \\ (\text { GAAP-P) } \end{array}$ | $\begin{array}{r} 12 / 10 \mathrm{~A} \\ (\text { GAAP-P) } \end{array}$ | $\begin{aligned} & 12 / 11 \mathrm{~F} \\ & \text { (IFRS-P) } \end{aligned}$ | $\begin{aligned} & 12 / 12 \mathrm{~F} \\ & \text { (IFRS-P) } \end{aligned}$ | $\begin{aligned} & \text { 12/13F } \\ & \text { (IFRS-P) } \end{aligned}$ |
| Operating revenue | 1,411.9 | 1,519.1 | 1,705.1 | 1,868.0 | 2,124.1 | Cash and cash equivalents | 63.7 | 56.3 | 53.1 | 86.8 | 91.4 |
| Cost of sales | 460.2 | 494.1 | 547.5 | 599.0 | 773.5 | Curent financial assets | 5.5 | 3.9 | 4.3 | 6.8 | 9.0 |
| Gross profit | 951.8 | 1,025.1 | 1,157.7 | 1,269.0 | 1,350.7 | Trade receivables | 194.6 | 207.3 | 210.0 | 220.0 | 230.0 |
| SGRA expenses | 747.5 | 796.3 | 870.8 | 934.1 | 986.4 | Inventories | 54.6 | 73.2 | 77.6 | 82.2 | 87.0 |
| Other operating income | 0.0 | 0.0 | (46.3) | (60.0) | (56.0) | Other current assets | 191.1 | 238.1 | 252.4 | 267.6 | 282.0 |
| Operating profit | 204.3 | 228.8 | 240.6 | 274.9 | 308.3 | Current assets | 509.5 | 578.8 | 597.4 | 663.4 | 699.4 |
| EBITDA | 352.4 | 382.6 | 453.0 | 506.1 | 540.7 | Investment assets | 130.7 | 204.3 | 230.4 | 259.3 | 279.3 |
| Non-operating accounts | (1.5) | 7.7 | 3.8 | 3.3 | 5.2 | Property, plant and equipment | 418.2 | 454.2 | 543.2 | 626.8 | 716.8 |
| Net financing income | (9.4) | (14.1) | (29.2) | (29.4) | (29.5) | Intangible assets | 141.1 | 133.6 | 134.0 | 134.0 | 134.0 |
| Profit on equity method | 13.9 | 22.1 | 28.0 | 30.0 | 32.0 | Deferred tax assets | 8.5 | 5.2 | 0.0 | 0.0 | 0.0 |
| Net other non-operating income | (6.0) | (0.3) | 5.0 | 2.7 | 2.7 | Other non-current assets | 62.8 | 63.4 | 63.4 | 63.4 | 63.4 |
| Profit before tax | 202.7 | 236.5 | 244.4 | 278.2 | 313.5 | Non-current assets | 761.2 | 860.7 | 971.0 | 1,083.5 | 1,193.5 |
| Income tax expense | 49.4 | 59.5 | 59.1 | 67.3 | 75.9 | Total assets | 1,270.7 | 1,439.5 | 1,568.4 | 1,746.9 | 1,892.9 |
| Net profit | 153.3 | 177.0 | 185.2 | 210.9 | 237.6 |  |  |  |  |  |  |
| Profit attributable to owners of parent | 153.3 | 177.0 | 185.2 | 210.9 | 237.6 | Trade payables | 29.2 | 38.3 | 40.6 | 43.1 | 45.5 |
| Total comprehensive income | 151.9 | 174.3 | 185.2 | 210.9 | 237.6 | Short-term financial liabilities | 239.7 | 104.5 | 115.0 | 160.0 | 150.0 |
| TCI, attributable to owners of parent | 151.9 | 174.3 | 185.2 | 210.9 | 237.6 | Curent provisions | 2.4 | 4.2 | 4.2 | 4.3 | 4.4 |
| Net exceptionals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | Other current liabilities | 270.4 | 294.0 | 301.9 | 308.0 | 314.0 |
| Adj. net profit | 153.3 | 177.0 | 185.2 | 210.9 | 237.6 | Current liabilities | 541.8 | 441.0 | 461.7 | 515.3 | 513.9 |
|  |  |  |  |  |  | Non-current financial liabilities | 30.0 | 219.8 | 219.8 | 219.8 | 219.8 |
| Cash Flow |  |  |  |  |  | Non-current provisions | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
|  |  |  |  |  |  | Provisions for employee benefits | 11.3 | 6.7 | 9.5 | 10.0 | 10.0 |
| (KRWbn) | 12/09A | 12/10A | 12/11F | 12/12F | 12/13F | Deferred tax liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net profit | 153.3 | 177.0 | 185.2 | 210.9 | 237.6 | Other non-current liabilities | 6.8 | 7.2 | 7.2 | 7.2 | 7.2 |
| Depreciation \& amorization | 148.1 | 153.8 | 166.2 | 171.2 | 176.4 | Non-current liabilities | 48.2 | 233.8 | 236.6 | 237.1 | 237.1 |
| Other non-cash adiustments | 59.2 | 53.5 | 45.1 | 52.1 | 60.9 | Total liabilities | 590.0 | 674.7 | 698.3 | 752.4 | 751.0 |
| Investments in working capital | (48.9) | (70.6) | (11.2) | (21.2) | (20.6) |  |  |  |  |  |  |
| Other operating cash flow | 0.0 | 0.0 | (53.9) | (67.3) | (75.9) | Issued capital | 40.7 | 40.7 | 40.7 | 40.7 | 40.7 |
| Cash flow from operating activities | 311.7 | 313.8 | 331.4 | 345.6 | 378.4 | Share premium | 141.9 | 140.0 | 140.0 | 140.0 |  |
| Capital expenditure | (204.1) | (211.9) | (230.0) | (230.0) | (230.0) | Other equity interest | (31.5) | (43.0) | (43.0) | (43.0) | (43.0) |
| Investments in intangibles | (6.2) | (14.7) | (15.0) | (15.0) | (15.0) | Accumulated other comprehensive income | 0.0 | (2.7) | (2.7) | (2.7) | ${ }_{1}^{(2.7)}$ |
| Changes in current financial assets | (0.1) | (3.3) | (3.4) | (3.5) | (3.6) | Retained earnings Equity atributable to owners of parent | 529.6 | 629.8 | 735.1 | 859.5 | 1,006.9 |
| Changes in investment assets | 2.8 | (65.1) | (80.0) | (80.0) | (80.0) | Equity attributable to owners of parent | 680.7 | 764.8 | 870.1 | 994.5 | 1,141.9 |
| Other investment cash flow | (68.6) | (1.3) | 0.0 | 0.0 | 0.0 |  |  |  |  |  |  |
| Cash flow from investing activities | (276.1) | (296.4) | (328.4) | (328.5) | (328.6) | Non-controlling Interests | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Proceeds from (repayments of debt | 51.4 | 54.5 | 55.0 | 55.0 | 55.0 | Total equity | 680.7 | 764.8 | 870.1 | 994.5 | 1,141.9 |
| Changes in equity | (38.9) | 0.0 | 0.0 | 0.0 | 0.0 |  |  |  |  |  |  |
| Dividends paid | (64.8) | (76.8) | (79.9) | (86.5) | (90.2) | Total Liab. and equity | 1,270.7 | 1,439.5 | 1,568.4 | 1,746.9 | 1,892.9 |
| Other financing cash flow | 0.0 | 1.9 | 18.7 | 48.0 | (10.0) |  |  |  |  |  |  |
| Cash flow from financing activities | (52.3) | (20.4) | (6.3) | 16.6 | (45.2) | Per-share Performance |  |  |  |  |  |
| Other cash flow | 4.4 | (4.3) | 0.0 | 0.0 | 0.0 |  |  |  |  |  |  |
| Increase/decrease in cash | (12.4) | (7.4) | (3.3) | 33.7 | 4.6 | (KRW) | 12/09A | 12/10A | 12/11F | 12/12F | 12/13F |
| Cash and cash equivalents at FYB | 76.1 | 63.7 | 56.3 | 53.1 | 86.8 | EPS | 2,023 | 2,294 | 2,431 | 2,805 | 3,160 |
| Cash and cash equivalents at FYE | 63.7 | 56.3 | 53.1 | 86.8 | 91.4 | Adj. EPS | 2,023 | 2,294 | 2,431 | 2,805 | 3,160 |
|  |  |  |  |  |  | BPS | 8,826 | 9,907 | 11,571 | 13,226 | 15,186 |
| Gross operating cash flow | 297.6 | 328.2 | 353.8 | 379.6 | 410.1 | SPS | 18,639 | 19,688 | 22,379 | 24,842 | 28,249 |
| Free cash flow | 32.4 | 30.7 | 97.6 | 113.3 | 144.5 | GCFPS | 3,928 | 4,253 | 4,643 | 5,048 | 5,454 |
| Net cash flow | (114.7) | (63.5) | (13.4) | (8.8) | 16.8 | DPS | 1,010 | 1,050 | 1,150 | 1,200 | 1,250 |
| Net cash (net debt) | (200.5) | (264.0) | (277.4) | (286.2) | (269.4) | 3yr CAGR of adj. EPS | 11.9 | 11.5 | 11.3 | 10.9 | 7.7 |
| Operating Statistics \& Ratios |  |  |  |  |  | Shareholder Value \& Financial Structure |  |  |  |  |  |
| (\%) | 12/09A | 12/10A | 12/11F | 12/12F | 12/13F | (\%) | 12/09A | 12/10A | 12/11F | 12/12F | 12/13F |
| OR growth | 7.4 | 7.6 | NA | 9.6 | 13.7 | ROE | 24.0 | 24.5 | 21.3 | 22.6 | 22.2 |
| OP growth | 7.4 | 12.0 | NA | 14.3 | 12.1 | ROA | 13.9 | 14.1 | 13.2 | 14.1 | 14.3 |
| EBITDA growth | 6.3 | 8.6 | NA | 11.7 | 6.8 | ROIC | 22.5 | 22.1 | 20.2 | 21.3 | 21.5 |
| NP growth of parent | 18.8 | 15.5 | 4.6 | 13.9 | 12.7 | WACC | 5.7 | 8.6 | 10.2 | 10.5 | 10.4 |
| Adj. NP growth | 18.8 | 15.5 | 4.6 | 13.9 | 12.7 | ROICNACC ( $x$ ) | 4.0 | 2.6 | 2.0 | 2.0 | 2.1 |
| OP margin | 14.5 | 15.1 | 14.1 | 14.7 | 14.5 | Economic proft (KRWbon) | 116.8 | 109.9 | 103.6 | 110.8 | 126.5 |
| EBITDA margin | 25.0 | 25.2 | 26.6 | 27.1 | 25.5 | Total liab.equity | 86.7 | 88.2 | 80.3 | 75.7 | 65.8 |
| NP margin | 10.9 | 11.7 | 10.9 | 11.3 | 11.2 | Net debt/equity | 29.5 | 34.5 | 31.9 | 28.8 | 23.6 |
| Adj. NP margin | 10.9 | 11.7 | 10.9 | 11.3 | 11.2 | Interest coverage ( x ) | 28.1 | 21.7 | 15.4 | 17.0 | 18.1 |

Note: Adj. EPS = [(Adjusted NP - preferred share dividends) + (after-tax dilution adjustment)] / (diluted avg. number of total ordinary shares outstanding)
Adjusted NP $=($ Parent NP) - [discontinued operation gains $+($ net exceptional gains $) \times(1$ - marginal tax rate) $]$
Net exceptional gains: Pre-tax exceptional gains (exceptional gains attributable to parent including FX gains, derivatives gains, valuation gains, and one-off gains)
Source: Company data, Hyundai Securities

[^1]
[^0]:    Source: Company data, Hyundai Securities

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