Korea Investment
& Securities Co., Ltd.

truefriend

Woongjin Coway (021240)

Company Brief / Consumer services

February 24, 2012

12M rating	**BUY (Maintain)**	
12M TP	**W47,000**	*from W47,000*
Up/downside	**+29%**	

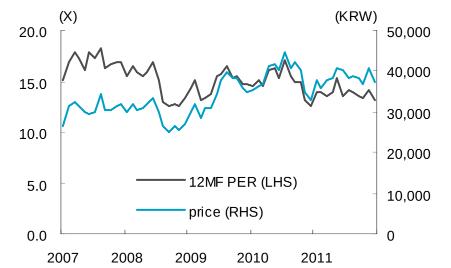
Stock Data

KOSPI (Feb 22, pt)	2,008
Stock price (Feb 22, KRW)	37,300
Market cap (USD mn)	2,512
Shares outstanding (mn)	77
52-Week high/low (KRW)	41,800/31,700
6M avg. daily turnover (USD mn)	5.7
Free float / Foreign ownership (%)	65.0/51.9
Major shareholders (%)	
WoongJin Holdings and 33 others	31.0
Lazard Asset Management LLC and 36 others	14.5

Performance

	1M	6M	12M
Absolute (%)	(5.3)	(1.8)	12.5
Relative to KOSPI (%p)	(8.3)	(14.9)	10.2

12MF PER trend



Source: WISEfn consensus

Hidden merits

Undervalued; EV to rise as stake sale progresses

Woongjin Coway (Coway) has pulled back since the largest shareholder Woongjin Holdings announced to sell its entire stake in Coway on Feb 6. The main trigger for the pullback was uncertainty about the buyer and how the acquisition process would unfold. Coway currently trades at 2012F PE 13.5x. Assuming a net cash position at Coway after the sale, the PE would be 12.6x. We expect Coway's enterprise value (EV) to be highlighted in the buyout process and the acquisition price will likely exceed the present value. As such, upside looks bigger than downside. We maintain BUY with a TP of W47,000 that equals 2012F PE 17x.

From de-rating to re-rating: Evaluation of environmental home appliances and other growing businesses

The environmental home appliances (EHA) business is confirmed to be up for sale but the cosmetics division is still undecided. Coway's stake in Woongjin Chemical (45.2%) and the water treatment business will likely be transferred to Woongjin Holdings. We believe the key is the pricing of EHA and other growing businesses. Although EHA has been an earner, overall profitability was eroded by loss-making new businesses for years. But we believe the EHA business is now ready for a fair valuation and we think it is time to bring other growing businesses and subsidiaries into the scope of evaluation. The best scenario would be a package sale of businesses (including those in undecided status) if their growth potential draws attention. But even if Woongjin Holdings can sell only the EHA division (meaning Coway retains it under a new owner and the holding company takes over the rest), the scenario is still positive as Coway should turn to a net cash position. Besides, EHA's profitability will further improve thanks to the focused approach by Coway. Above all, Coway can make a fresh start backed by its cash generating ability of more than W500bn in annual EBITDA.

M&A value more than W47,000/sh

The M&A value of Coway is estimated at W3.5trn, or W47,000 per share, using DCF for domestic EHA (W3.6trn) and mark-to-market or book value for other businesses (W305bn). The value goes up in a more aggressive scenario where we use SoP valuation for each division (other businesses valued at over W700bn).

	2009A	2010A	2011F	2012F	2013F
Sales (W bn)	1,412	1,519	1,710	1,927	2,143
OP (W bn)	204	229	243	282	314
EBT (W bn)	203	237	230	269	301
NP of con. int. (W bn)	153	195	175	204	228
EBITDA (W bn)	352	383	415	468	514
Net debt (W bn)	200	264	305	298	308
OPM (%)	14.5	15.1	14.2	14.6	14.6
ROE (%)	24.0	27.2	22.0	22.9	22.5
Dividend yield (%)	2.6	2.6	2.9	3.3	3.6
EPS (KRW)	2,034	2,561	2,341	2,758	3,081
chg. (% YoY)	17.3	25.9	(8.6)	17.8	11.7
BPS (KRW)	9,298	10,165	11,334	12,750	14,397
DPS (KRW)	1,010	1,050	1,050	1,200	1,300
PE (x)	18.9	15.7	15.6	13.5	12.1
PB (x)	4.1	4.0	3.2	2.9	2.6
EV/EBITDA (x)	8.9	8.7	7.5	6.7	6.1

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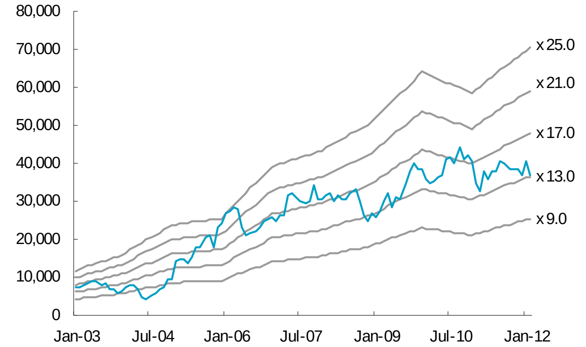
Tumbled on up-for-sale announcement; Valuation close to historical low

On Feb 6, Woongjin Holdings announced it would sell its entire stake in Coway on the open market. Following the news, Coway's share price has fallen 13% due to uncertainty about the buyer and sale method. Some also worry the sell-off may damage Coway's unique business model combining door-to-door sales, rental and maintenance services without strong ownership. Coway trades at 2012F PE 13.5x, close to the lower end of the historical band. Assuming the sale of the EHA business alone and a net cash position afterward, the PE would be 12.6x. Otherwise, if equity-method gains are added from subsidiaries excluded from K-IFRS separate accounting, the PE would be 11.4x. The 2012F EV/EBITDA comes to 6.6x and if the rental asset disposal loss is factored in, the figure would be 5.5x.

PE close to lower end after pullback on uncertainty



Source: Korea Investment & Securities

NP upside according to cash flow and equity-method gains (W bn)

	NP	EPS	PE
K-IFRS separate	204	2,758	13.5
Assuming sale of EHA business alone and a net cash position	220	2,963	12.6
Addition of equity-method gains	242	3,269	11.4

Note: In calculating equity-method gains, Woongjin Chemical's NP is based on consensus

Source: Korea Investment & Securities

Stake sale to highlight EV

Coway is currently in the process of due diligence since naming a lead manager. The stock's volatility may increase depending on uncertainty about the buyer and future issues. But upside looks bigger than downside as Coway's EV should be highlighted during the sale process and the acquisition price will likely exceed the present value. We believe the key is the pricing of EHA and other growing businesses. The EHA division is up for sale while the status of the cosmetics division is undecided. As for Woongjin Chemical and the water treatment business, no significant change in valuation is expected as the two will likely be transferred to Woongjin Holdings. The best scenario would be a package sale of businesses (including those in undecided status) if their growth potential draws attention and is evaluated accordingly. But even if Woongjin Holdings can sell only the EHA division, the scenario is still positive as Coway should turn to a net cash position (cash proceeds from holdings of other businesses). Besides, EHA's profitability will further improve thanks to the focused approach.

M&A timetable

Feb 2012	- Announcement of stake sale - Named Goldman Sachs as lead manager - Due diligence (currently under way) - Teaser letters to be sent no later than end-Feb
Mar 2012	- Selection of preferred bidder(s)
Jun 2012	- Selection of final buyer and completion of sale process

Source: Korea Investment & Securities

Coway's business portfolio

	Division (subsidiary)	Products/brand	Type of sales	2012F sales	Market players and share
Up for sale	EHA	Water purifier Bidet Air purifier Water softener Food waste disposal	Door-to-door/test sales - Rental - Lump-sum payment - Membership	W1.67trn	Water purifier: Coway (52%) Chungho Nais (11%) Air purifier: Coway (50%) (16%) Samsung Electronics (16%) Bidet: Coway (48%) Novita (21%)
	Overseas	EHA	Overseas affiliates - General sales network - OEM	W191bn	Global home appliance makers
Undecided	Cosmetics (domestic)	Premium line and herbal cosmetics	Door-to-door /test sales	W100bn	AmorePacific, LG H&H, others
	Chinese subsidiary	Cosmetics EHA	Via sales agents/ test sales	W50bn (test sales W120bn)	Chinese cosmetics maker
Not for sale	Woongjin Chemical	Fiber and filter		W1.2trn	Kurita, Toray

Source: Korea Investment & Securities

M&A value more than W47,000/sh

Before determining the value of each division, we look at what benefits a potential buyer would get from the deal. A takeover of Coway would add to a buyer's profit by W68bn based on 2012 earnings. According to our analysis, a buyer's interest expenses from the acquisition would almost match equity-method gains if we assume the acquisition price reflects controlling rights premium of up to 70% of the current stake value (pro rata share of Coway's current market cap). Even if the controlling rights premium is taken into account, the post-sale stock price will still have upside from the current level. Meanwhile, intangible assets such as

Coway's dominance in the EHA market and growing cosmetics business are not factored in our assessment of the M&A value.

A potential buyer's equity-method gains to exceed interest expenses if the acquisition price is W1.5trn or less (W bn)

Premium	Acquisition price	Interest expenses	Equity-method gains
30%	1,145	52	68
50%	1,321	59	68
70%	1,497	67	68

Note: 1) Assuming acquisition of 31% stake.
2) Based on K-IFRS non-consolidated NP; No additional borrowings after the sale.
Source: Korea Investment & Securities

As mentioned, attention is given to the EHA and cosmetics divisions for the Coway sale. If conservatively assuming only the EHA business is sold, the M&A value comes to W3.5trn, or W47,000 per share. Other businesses are valued at W305bn using mark-to-market or book value.

Coway's M&A value more than W47,000/sh (W bn)

	2012F	2013F	2014F	2015F	2016F	2017F
NOPLAT	215.2	226.9	238.2	249.5	262.0	275.1
Depreciation and intangible asset amortization	151.2	162.7	173.0	182.7	191.7	201.3
Loss on disposal of rental assets	45.8	48.8	50.9	54.8	58.0	58.0
Chg. in working capital	(34.8)	(49.9)	(55.7)	(50.3)	(52.8)	(55.5)
Capex	(185.3)	(190.0)	(193.2)	(200.5)	(200.5)	(200.5)
FCF	**192.2**	**198.6**	**213.2**	**236.2**	**258.4**	**278.4**
Avg. cost of equity	7.2%					
Present value of FCF	887.7					
Residual value	2,756.8					
Operating value of domestic environmental appliances div. (a)	**3,644**					
Investment securities value (b)	**85** BV as of end-3Q11					
Woongjin Chem value (c)	**220** Current market cap*equity stake					
EV (d)=(a)+(b)+©	**3,949**					
Net debt (e)	**(467)** As of end-2012					
Capital value (e)-(d)	**3,482**					
Shares	74,134,796 Minus 2.99mn treasury stocks					
Per-share value (KRW)	**46,975**					

Note: 1) Assuming the EHA division's normal OPM of 16%
2) WACC based on risk-free interest rate of 4% and risk premium of 5%
3) Residual value based on 0% growth rate
Source: Korea Investment & Securities

In a more aggressive scenario, we use a SoP analysis of each of Coway's business segments. It pegs the M&A value at W3.9trn, or W52,750 per share.

Except domestic EHA, the value of other divisions can vary (W bn)

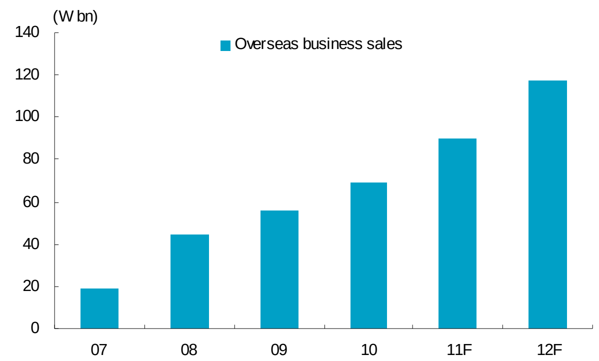
Operating value by division		
Domestic environmental appliance (a)	**3,644**	
Other businesses and subsidiaries (b)	**733**	
Overseas environmental appliance	191	1x 2012F PS
Domestic cosmetics	102	1x 2012F PS
Chinese cosmetics	189	15x 2012F PE
Woongjin Chem	220	Current market cap*equity stake
Other water treatment business	31	Green N Tech's BV
EV (c) = (a)+(b)	**4,378**	
Net debt (d)	**(467)**	
Capital value (d)-(c)	**3,911**	
Per-share value (KRW)	52,750	

Source: Korea Investment & Securities

EHA value at home and abroad: W3.6trn + α

Aside from the poor profitability of the cosmetics and water treatment businesses, rentals are set to see better profitability. The DCF value of the EHA business is W3.6trn reflecting the stable cash flow and assuming an OPM of 17% from the rental business. For rentals, the present subscriber base guarantees a cash flow over the next four to five years. The domestic EHA business is bound to grow as income levels rise. Moreover, the business has still growth potential considering the low penetration rate of air purifiers, bidets and water softeners. We expect sustained growth for the business given the recent net increase in the number of subscribers, more items purchased per person, various services including lump sum payment and membership and expanded sales channels. Overseas EHA sales are also growing fast. The main driver of the growth is the Malaysian subsidiary that is making a significant push with a rising number of rental subscribers and OEM and large business partners.

Strong growth of overseas EHA sales

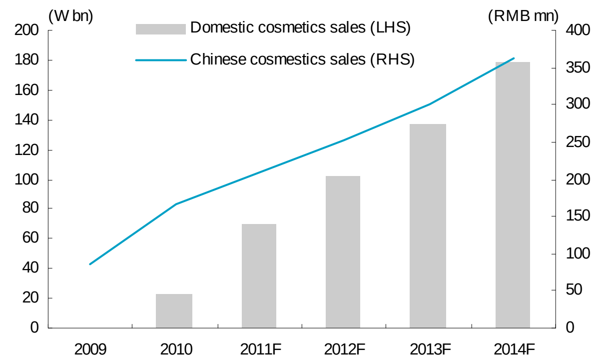


Source: Company data, Korea Investment & Securities

Value of cosmetics business will vary depending on buyer

The value of Coway's cosmetics businesses at home and abroad is constantly on the move. The cosmetics business in China whose book value is a mere W33bn is expected to generate an annual NP of more than W10bn. Moreover, the domestic cosmetics business made operating losses until 2011. However, the business is currently building up its brand recognition by developing premium products and new lines and offering aggressive promotions, and is poised to break even in 2012. Assuming Coway sells its cosmetics divisions, we believe the valuation will be based on their growth potential rather than NP value. The domestic cosmetics business is valued at W101.8bn with 2012F PS 1.0x. The PS for main rivals AmorePacific and LG Household & Health Care (LG H&H) are 2.0x and 2.5x, respectively, while the low-end cosmetics maker Able C&C stands at 1.0x. For the Chinese subsidiary, we estimate its value at W189bn using a target PE 15.0x the 2012F NP. We believe the target PE is fair given that the Chinese cosmetics business is on a comeback trail backed by shop overhauls in 2011 and new brand launches.

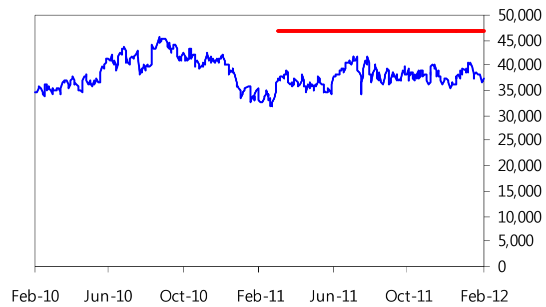
Robust sales growth at domestic and Chinese cosmetics businesses



Source: Korea Investment & Securities

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Woongjin Coway (021240)	03-25-11	BUY	W47,000



Balance sheet (W bn)

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
Current assets	509	579	682	731	791
Cash & cash equivalents	64	56	120	96	86
Accounts & other receivables	199	218	245	276	307
Inventory	55	73	82	93	103
Non-current assets	761	861	948	1,042	1,136
Investment assets	131	204	230	259	288
Tangible assets	418	454	490	526	562
Intangible assets	141	134	150	170	189
Total assets	1,271	1,440	1,630	1,772	1,927
Current liabilities	542	441	383	408	428
Accounts & other payables	155	190	214	241	268
ST debt & bonds	120	74	29	0	0
Current portion of LT debt	120	30	30	30	30
Non-current liabilities	48	234	385	387	389
Debentures	0	50	100	100	100
LT debt & financial liabilities	30	170	270	270	270
Total liabilities	590	675	768	795	817
Paid-in capital	41	41	41	41	41
Capital surplus	142	140	140	140	140
Capital adjustments	(32)	(43)	(43)	(43)	(43)
Retained earnings	530	630	727	842	974
Shareholders' equity	681	765	862	977	1,109
Adj. shareholders' equity	681	750	840	949	1,076

Income statement (W bn)

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
Sales	1,412	1,519	1,710	1,927	2,143
Gross profit	952	1,025	1,170	1,315	1,457
SG&A expenses	747	796	883	982	1,087
Other operating gains	0	0	(45)	(51)	(56)
Operating profit	204	229	243	282	314
Financial income	3	4	5	6	5
Interest income	3	4	5	6	5
Financial expenses	14	18	17	19	18
Interest expenses	13	18	17	19	18
Other non-operating profit	(5)	(0)	0	0	0
Gains (Losses) in associates, subsidiaries and JV	14	22	0	0	0
Earnings before tax	203	237	230	269	301
Income taxes	49	59	55	65	72
Net profit	153	177	175	204	228
Other comprehensive profit	0	0	0	0	0
Total comprehensive profit	153	177	175	204	228
EBITDA	352	383	415	468	514
Adj. net profit	153	195	175	204	228

Cash flow (W bn)

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
C/F from operations	312	314	292	357	365
Net profit	153	177	175	204	228
Depreciation	128	132	148	159	170
Amortization	20	22	24	27	30
Net incr. in W/C	(49)	(71)	(56)	(35)	(65)
Others	60	54	1	2	2
C/F from investing	(276)	(296)	(253)	(273)	(287)
Capex	(218)	(223)	(184)	(195)	(206)
Decr. in fixed assets	14	11	0	0	0
Incr. in investment	3	(68)	(26)	(29)	(29)
Net incr. in intangible assets	(6)	(15)	(41)	(47)	(49)
Others	(69)	(1)	(2)	(2)	(3)
C/F from financing	(52)	(20)	25	(107)	(89)
Incr. in equity	7	2	0	0	0
Incr. in debt	51	55	105	(29)	0
Dividends	(65)	(77)	(80)	(78)	(89)
Others	(45)	0	0	0	0
C/F from others	4	(4)	0	0	0
Increase in cash	(12)	(7)	63	(23)	(11)

Key financial data

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
Per-share data (KRW)					
EPS	2,034	2,561	2,341	2,758	3,081
BPS	9,298	10,165	11,334	12,750	14,397
DPS	1,010	1,050	1,050	1,200	1,300
Growth (%)					
Sales growth	7.4	7.6	12.5	12.7	11.2
OP growth	7.4	12.0	6.0	16.3	11.2
NP growth	18.8	27.1	(10.2)	16.9	11.7
EPS growth	17.3	25.9	(8.6)	17.8	11.7
EBITDA growth	6.3	8.6	8.4	12.9	9.7
Profitability (%)					
OP margin	14.5	15.1	14.2	14.6	14.6
NP margin	10.9	12.8	10.2	10.6	10.7
EBITDA margin	25.0	25.2	24.3	24.3	24.0
ROA	13.1	13.1	11.4	12.0	12.3
ROE	24.0	27.2	22.0	22.9	22.5
Dividend yield	2.6	2.6	2.9	3.3	3.6
Stability					
Net debt (W bn)	200	264	305	298	308
Debt/equity ratio (%)	39.6	42.4	49.7	40.9	36.0
Valuation (x)					
PER	18.9	15.7	15.6	13.5	12.1
PBR	4.1	4.0	3.2	2.9	2.6
PSR	2.1	2.0	1.7	1.5	1.3
EV/EBITDA	8.9	8.7	7.5	6.7	6.1

Note: 1. K-IFRS separate
2. EPS and BPS are calculated using adjusted net profit and shareholders' equity that includes equity-method gains/losses

■ **Guide to Korea Investment & Securities Co., Ltd. stock ratings based on absolute 12-month forward share price performance**

- BUY: Expected to give a return of +15% or more
- Hold: Expected to give a return between -15% and +15%
- Underweight: Expected to give a return of -15% or less

■ **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.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- 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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Korea Investment & Securities Co., Ltd., or its affiliates was not making a market in Woongjin Coway's securities at the time that the research report was published.

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Korea Investment & Securities Co., Ltd. has not provided this report to various third parties.
Neither the analysts covering these companies nor their associates own any shares of as of February 24, 2012.

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