Daishin Securities

Woongjin Coway (021240)

Coway still shines without Woongjin

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BUY

[initiate]

Other services

CV W36,550

TP ▲ 40% W51,000

KOSPI	2018.3
Market cap (Wbn)	2,819
Market cap portion (%)	0.2%
Paid-in capital (common; Wbn)	41
52w high/low (W)	41,800 / 31,700
120d avg. trading volume (Wbn)	6.6
Foreign ownership (%)	52.0%
Major shareholders	Woongjin Holdings and 33 31.0% Lazard Asset Mgmt. and 36 14.5%

(%)	1W	1M	3M	12M
Abs. return	-2.1	-2.4	-3.4	7.8
Rel. return	-1.4	-2.6	-10.3	6.9

Investment points

Woongjin Coway shares are oversold due to Woongjin Holdings' plan to sell its stake in the company. The fundamentals are intact as growth will continue and profit gains will accelerate this year despite economic weakness. It is time to buy the stock based on robust fundamentals.

Quick view

Initiate coverage with BUY and 6M TP of W51,000

- Target price derived from SOTP combining DCF-based operating value and the value of investment assets.
- The outlook favorable for 2012 amid strength in the rental business and the narrowing of losses in the cosmetics business: sales and OP forecast to rise 10.4% and 16.2% yoy, respectively
- The stock currently trades at a 2012E P/E of 14.7x, undervalued relative to Amore Pacific and LG Household & Healthcare.

Stable growth and cash flow gains continue on environmental appliances demand and increased product line-up

- Order intake hit a record in 2011, reflecting rising demand for environmental home appliances amid increased environmental awareness and wellness trends.
- The existing customer base alone is big enough to support stable growth: 80% rental renewal rate, low churn, increasing product per customer (PPC).
- New product additions continue, including mattresses introduced in 2011.
- The food waste disposer market's growth at home with the increased adoption of pay-as-you-go garbage collection system will provide long-term growth opportunities along with rising exports.

Uncertainty over sale is not much of a risk

- Depending on who takes over Woongjin Coway, new growth opportunities will open up. Coway has little to lose by leaving Woongjin Holdings.
- Given its overwhelming lead, Coway will not likely slow in earning growth during the transition.
- Excellent cash flows, a strong door-to-door sales force, and a solid customer base are advantages for Coway's business growth.

Operating results and major financial data (Wbn, W, %)

	2010A	2011A	2012F	2013F	2014F
Sales	1,502	1,710	1,887	2,076	2,230
OP	254	242	282	328	366
Pretax profit	243	225	253	299	341
NP	183	177	192	227	259
NP (controlling int.)	177	177	192	227	259
EPS	2,376	2,296	2,490	2,941	3,353
PER	17.0	15.9	14.7	12.4	10.9
BPS	9,504	9,719	11,199	13,035	15,186
PBR	4.2	3.8	3.3	2.8	2.4
ROE	25.9	23.9	23.8	24.3	23.8

Note: Based on the OP figures released by the company; EPS, BPS, and ROE are based only on the controlling interests; Per share values are inclusive of treasury shares. Source: Woongjin Coway, Daishin Securities Research Center

I. Valuation

Initiate coverage with BUY and 6M TP of W51,000

BUY, 6M TP of W51,000

We initiate our coverage of Woongjin Coway with a BUY rating and a six-month target price. Woongjin Coway, the largest rental company of environmental home appliances in Korea, has built an unrivalled market position backed by differentiated product quality, door-to-door sales force advantages, and a strong brand image. Despite concerns over the rental market's saturation, the company continues to achieve stable growth by keeping up with new demand and steady replacement demand for environmental home appliances.

DCF is a better measure of the company's operating value than PER

We have valued Woongjin Coway based on the sum-of-the-parts (SOTP) method combining DCF-based operating value (terminal growth 2% and WACC 8.5%) and the value of investment assets (Woongjin Chemical and a Chinese subsidiary).

Rental services, which represent Woongjin Coway's core business, have strong continuity. Rental contracts set for five-year terms typically last for an average of four years, and the renewal rate is more than 80%. Cash flows are negative in the early rental contract period but turn positive over time. Therefore, the DCF method, which fully captures the company's unique business model and cash flows over a period of time, is a better measure of the company's operating value than PER, which captures the operating value at a specific point in time.

The 2% terminal growth rate looks reasonable because the company's dominant market presence keeps replacement demand strong and constant product upgrades keep product prices high. EBITDA includes cashless rental property disposal losses.

Fig 1. Woongjin Coway WACC

WACC		
Risk-free rate of return	a	5.0%
Beta	b	0.85
Market premium	c	5.0%
Cost of equity	A=a+(b*c)	9.3%
Effective tax rate	d	24.2%
Interest rate on borrowings	e	6.00%
Cost of debts	B=e*(1-d)	4.5%
Market capitalization	g	2,876.8
Total borrowings	h	578.2
Weight for the cost of debts	C=h/(g+h)	16.7%
WACC	A*(1-C)+B*C	8.5%

Source: Daishin Securities Research Center

Fig 2. Woongjin Coway valuation (Wbn)

		2012E	2013E	2014E	2015E	2016E	2017E
Total firm value	E=d+e	4,050					
OP	a	282	328	366	403	415	427
Depreciation/amortization cost + Loss on rental properties abandoned	b	205	213	228	244	243	251
EBITDA	a+b	487	542	594	647	658	678
Effective tax rate (%)		24.0	24.2	24.2	24.2	24.2	24.2
EBITDA*(1-t)	A	370	410	450	490	499	514
(Depreciation/amortization cost)*t	B	49	52	55	59	59	61
Net working capital growth	C	2.3	17.8	7.0	10.5	4.0	3.0
CAPEX	D	270	270	250	250	240	240
FCFF	A+B-C-D	147	174	249	289	313	332
Discount factor		0.94	0.80	0.73	0.68	0.62	0.57
PV of FCFF		138	139	182	195	195	191
Total PV of FCFF(until 2016)	d	1,040					
Terminal value of end of 2016		5,237	Terminal growth 2%				
NPV of terminal value	e	3,010	WACC 8.5%				
Investment asset value	F=h+i	271					
Woongjin Chemical	h	146	30% off from market cap				
Chinese subsidiary	i	125	P/E of 15.0x applied to 2012E EPS				
Total value of equity	G=E+F-j+k	3,834					
Total borrowings	j	578					
Cash and cash equivalents	k	92					
Total number of issued shares ('000)	m	77,125					
Treasury shares ('000)	n	2,990					
Per share value (KRW)	H=G/(m-n)	51,720					
Target price (KRW)		**51,000**					
Current share price		36,550	2012-03-09				
Upside potential (%)		39.5					
12M Fwd EPS (W)		2,675	Exclusive of equity method gains/losses and treasury shares				
P/E implied in target price (x)		19.1					
12M Fwd EPS (W)		2,869	Inclusive of our equity method gain/loss estimate				
Target price implied P/E (x)		17.8					

Source: Daishin Securities Research Center

Target price translates into a 12M Fwd P/E of 19.1x

Among investment assets, we have valued the Chinese subsidiary at a target P/E of 15x 2012E EPS and Woongjin Chemical at a 30% discount. We have excluded minor subsidiaries such as Green Entech from our valuation.

The 12-month forward P/E implied in the W51,000 target price is 19.1x (or 19.8x if including treasury shares) on an unconsolidated basis.

Equity method gains from Woongjin Chemical and the Chinese subsidiary are forecast at W13.3bn or W180/share in 2012, which reduces the implied P/E to 17.8x.

Amore Pacific and LG Household & Healthcare as peers

We have used unconsolidated data for peer comparisons. Overseas subsidiary sales are small if intra-company transactions are excluded. EPS is expected to grow W180 in 2012.

We have excluded Lock & Lock and Orion from comparison because of the importance of their China growth story to their valuations. Amore Pacific and LG Household & Healthcare are best for peer comparisons in terms of business stability and profitability.

Woongjin Coway has no reason to be discounted relative to Amore Pacific or LG Household & Healthcare

Woongjin Coway's OP margin is similar to that of Amore Pacific, while its EBITDA margin is the highest among domestic demand-oriented companies (including Amore Pacific and LG Household & Healthcare). The premium valuations of Amore Pacific and LG Household & Healthcare have been driven by their inorganic growth and growth optimism for the domestic cosmetics market.

Amore Pacific and LG Household & Healthcare currently trade at a 2012 P/E of over 20x, even though their EPS growth is slowing this year, compared with Woongjin Coway, which trades at a 2012E P/E of 14.7x. Woongjin Coway's valuation discount to peers is even wider based on EV/EBITDA that reflects cash flows.

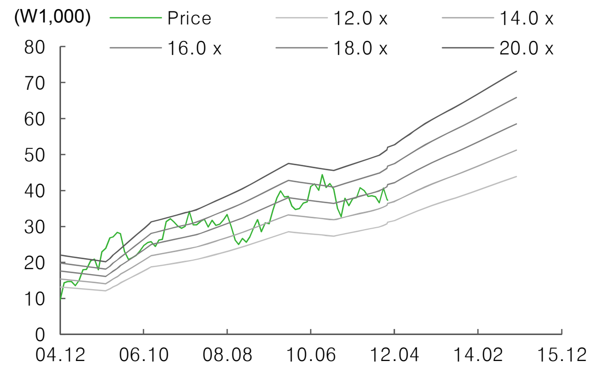
Fig 3. Peers' investment metrics

(Wbn, %)

Code Company name		A021240 Woongjin Coway	A090430 Amore Pacific	A051900 LG H&H	A115390 Lock & Lock	A001800 Orion	A035760 CJ O Shop.
Share price (March 9)		36,550	1,081,000	525,000	30,500	762,000	279,500
Total # of issued shares		77,124,796	5,845,849	15,618,197	55,000,000	5,965,232	6,203,265
Market cap (Wbn)		2,819	6,319	8,200	1,678	4,546	1,734
Sales (Wbn)	2011E	1,710	2,555	3,452	476	1,903	895
	2012E	1,887	2,850	3,934	591	2,233	974
	2013E	2,076	3,177	4,401	733	2,566	1,117
OP (Wbn)	2011E	242	373	401	73	221	133
	2012E	282	416	505	109	270	155
	2013E	328	473	561	138	320	172
EBITDA (Wbn)	2011E	439	454	495	91	320	150
	2012E	487	511	604	132	373	168
	2013E	542	575	667	165	433	186
EPS (W)	2011E	2,296	55,983	17,385	915	21,950	17,001
	2012E	2,490	48,621	19,254	1,518	28,633	20,261
	2013E	2,941	55,713	22,921	1,905	35,502	24,219
BPS (W)	2011E	9,719	224,534	39,274	7,784	124,784	59,253
	2012E	11,199	341,561	80,956	11,986	218,282	88,749
	2013E	13,035	390,436	101,348	13,831	255,659	112,078
OP margin (%)	2011E	14.2	14.6	11.6	15.4	11.6	14.8
	2012E	14.9	14.6	12.8	18.4	12.1	16.0
	2013E	15.8	14.9	12.8	18.8	12.5	15.4
EBITDA margin (%)	2011E	23.9	17.7	14.4	18.8	16.8	17.3
	2012E	23.8	17.9	15.3	22.2	16.7	17.3
	2013E	24.3	18.1	15.2	22.5	16.9	16.6
ROE (%)	2011E	23.9	16.8	29.4	12.6	15.1	27.0
	2012E	23.8	15.6	28.1	13.9	16.0	25.8
	2013E	24.3	15.2	26.6	14.9	17.0	24.9
PER (x)	2011E	15.9	18.8	28.0	41.9	30.9	15.2
	2012E	14.7	22.2	27.3	20.0	26.5	14.1
	2013E	12.4	19.4	22.9	16.0	21.4	12.0
PBR (x)	2011E	3.8	3.7	7.6	3.8	3.6	3.6
	2012E	3.3	3.2	6.5	2.5	3.5	3.2
	2013E	2.8	2.8	5.2	2.2	3.0	2.5
EV/EBITDA (x)	2011E	7.6	12.0	17.0	16.9	14.6	12.4
	2012E	6.8	11.3	13.5	11.9	12.6	13.5
	2013E	6.1	9.8	11.8	9.3	10.7	9.1
NP (Wbn)	2011E	177	327	272	50	131	90
	2012E	192	336	325	84	171	123
	2013E	227	385	406	105	212	145
2011-2013 EPS CAGR (%)		13.2	(0.2)	14.8	44.5	27.3	17.1

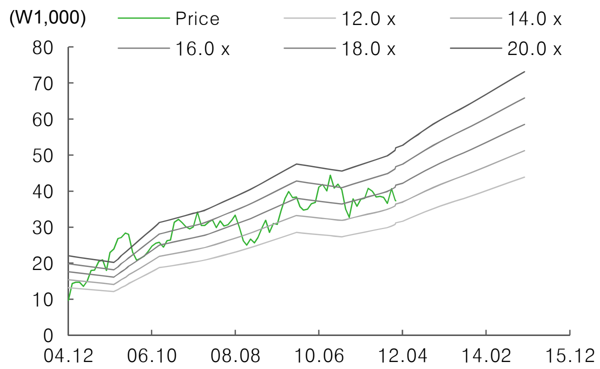
Note: Figures for Woongjin Coway are our own estimates, while those for the other companies are based on the market consensus (2011 preliminary results when available). Figures for Woongjin Coway and CJ O Shopping are based on their unconsolidated results, while those for the other companies are based on their consolidated results.
Source: QuantWise, Daishin Securities Research Center

Fig 1. Woongjin Coway's 12M Fwd P/E band



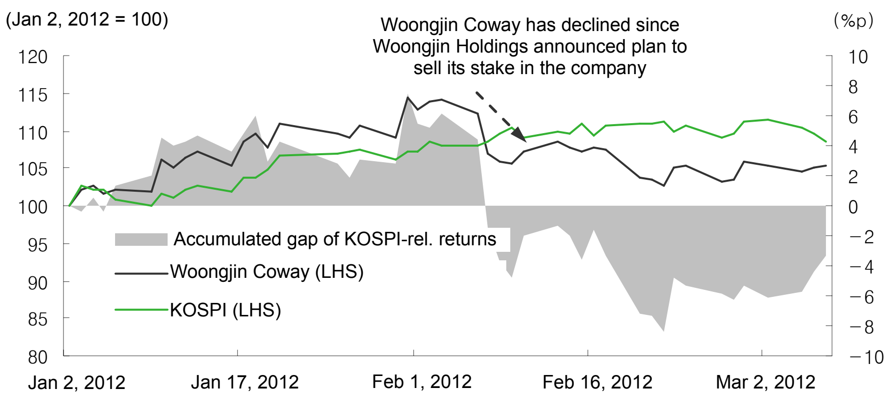
Note: Figures until 2010 are based on K-GAAP, while those for 2011 and beyond are based on IFRS (unconsolidated; excluding equity method gains).
Source: Woongjin Coway, Daishin Securities Research Center

Fig 2. Woongjin Coway's 12M Fwd EV/EBITDA band



Note: Figures until 2010 are based on K-GAAP, while those for 2011 and beyond are based on IFRS (unconsolidated).
Source: Woongjin Coway, Daishin Securities Research Center

Fig 3. Woongjin Coway's YTD share price movement in absolute and KOSPI-rel. terms



Source: Quantwise, Daishin Securities Research Center

Woongjin Coway is under pressure after sale announcement; currently undervalued relative to fundamentals

Woongjin Coway outperformed the broad stock market in January and early February after favorable 4Q11 results. Woongjin Coway shares came under selling pressure following Woongjin Holding's announcement of a plan to sell its stake.

As the sale takes shape, Woongjin Coway's fundamentals will get a fresh look, while expectations rise for growth under new ownership.

II. Earnings and outlook

Double-digit sales and profit growth ahead for 2012

1Q12 results should be favorable with sales and OP rising 11% and 14%, respectively

In 1Q12, Woongjin Coway's sales and OP are forecast to expand 11.1% and 13.7% yoy, respectively, to W444.0bn and W64.2bn with an OP margin of 14.5%. Order intake tends to slow qoq in the first quarter of the year due to fewer operating days and a lull in sales promotions and new product releases. Yet, the rental business' growth will reach 10% in 1Q12, propelled by customer growth during 2Q11-3Q11 and low cancellation rates, which will lift total sales 11.1%. Going forward, rental order growth will quicken. In March when seasonal yellow dust storms from China begin to affect the Korean peninsula, Woongjin Coway will launch sales promotions for air humidifier cleaners. The company will also roll out new products such as table-type ice and water dispensers.

In 4Q11, price increases for long-term membership customers with a 9-10 year history led to some customer defections and a drop in membership accounts. Recently, the company rolled back the price increases and extended membership services to mattresses. The number of membership accounts will likely rebound in 2Q12.

In 2012, the number of rental orders is forecast to reach 1,265,000 on the addition of mattresses to the product portfolio

Rental order intake hit a record 1,270,000 in 2011. Monthly cancellation rates averaged 1.04%, the second lowest since 2007 (1.00%). The number of rental customers rose 305,000, the largest increase since 2006.

In 2012, the number of rental orders is forecast to reach 1,265,000. The contributing factors are robust sales of mattresses launched in November 2011 and the introduction of air humidifier cleaners and small-sized water dispensers aimed at single-person households. The monthly average cancellation rate is expected to fall to a record low of 0.99% in 2012, helped by contract obligation period extensions and service quality upgrades.

For all of 2012, sales will climb 10.4% to W1,887.1bn on increased sales to overseas subsidiaries in Malaysian and other countries and water treatment business revenue recovery.

Fig 4. Woongjin Coway quarterly earnings forecast

(Wbn)

		1Q11	2Q11	3Q11	4Q11	1Q12F	2Q12F	3Q12F	4Q12F
Rental orders ('000 units)		330	342	288	313	287	344	313	321
Mthly avg cancellation rate (%)		1.02%	1.02%	0.99%	0.95%	1.07%	0.97%	0.96%	0.96%
# of rental customer accounts ('000)		4,234	4,321	4,377	4,450	4,486	4,604	4,674	4,751
# of membership accounts ('000)		967	1,011	1,034	1,002	1,006	1,024	1,049	1,074
Total # of managed accounts ('000)		5,201	5,333	5,411	5,452	5,493	5,628	5,723	5,825
Chg in total # of managed accounts ('000)		118	132	78	41	41	135	96	101
Sales	Total	399.8	435.9	430.1	444.0	444.0	480.1	478.2	484.9
	Rental	288.0	299.7	305.7	312.9	316.2	323.6	330.3	335.6
	Membership	39.1	39.9	41.0	40.8	40.2	40.9	41.9	43.1
	Bullet payment	31.8	38.8	35.7	31.9	34.1	43.2	41.9	35.9
	Others	23.5	39.6	30.2	43.1	33.5	45.5	39.0	50.2
	Exports	18.3	22.9	24.5	32.4	23.8	29.8	31.9	40.5
	Water treatment	0.2	5.0	3.0	5.5	4.0	4.0	4.0	4.0
	Living and other	5.0	11.7	2.7	5.2	5.8	11.7	3.2	5.7
	Cosmetics	17.4	17.9	17.6	15.3	20.0	27.0	25.0	20.0
Sales growth (% yoy)	Total	7.7	18.9	13.8	11.3	11.1	10.1	11.2	9.2
	Rental	6.0	9.5	10.5	10.0	9.8	8.0	8.1	7.2
	Membership	9.8	9.0	9.3	7.3	2.9	2.3	2.4	5.7
	Bullet payment	19.1	56.8	45.8	1.6	7.2	11.3	17.2	12.6
	Others	-36.9	24.9	-19.7	83.8	42.7	14.8	29.4	16.5
	Exports	5.6	33.1	60.1	67.1	30.0	30.0	30.0	25.0
	Water treatment	-97.4	22.0	-64.3	150.0	1,900.0	-20.0	33.3	-27.3
	Living and other	-59.1	12.5	-82.9	179.7	15.0	0.0	20.0	10.0
	Cosmetics			897.4	-29.0	15.2	50.8	42.0	30.5
GP		274.3	294.6	295.3	293.7	305.3	327.7	327.8	328.9
	(% yoy)	13.4	19.8	18.8	6.8	11.3	11.3	11.0	12.0
OP		56.5	61.8	61.4	62.8	64.2	72.4	72.1	73.0
	(% yoy)	-18.4	-13.3	2.7	18.1	13.7	17.2	17.3	16.2
Pretax profit		50.4	55.1	64.6	55.2	56.6	65.0	64.9	66.1
	(% yoy)	-22.1	-27.5	22.4	10.9	12.3	18.0	0.5	19.7
NP		38.8	42.1	49.2	47.1	43.0	49.4	49.3	50.3
	(% yoy)	-24.7	-28.9	36.6	28.6	11.1	17.4	0.3	6.7
EBITDA		104.6	110.4	111.5	112.7	115.4	123.5	123.6	124.6
	(% yoy)	-7.1	-5.2	8.3	9.2	10.3	11.9	10.9	10.6
GP margin (%)		68.6	67.6	68.7	66.1	68.8	68.3	68.5	67.8
OP margin (%)		14.1	14.2	14.3	14.1	14.5	15.1	15.1	15.0
EBITDA margin (%)		26.2	25.3	25.9	25.4	26.0	25.7	25.8	25.7
Pretax margin (%)		12.6	12.6	15.0	12.4	12.8	13.5	13.6	13.6
NP margin (%)		9.7	9.7	11.4	10.6	9.7	10.3	10.3	10.4

Source: Daishin Securities Research Center

Fig 5. Woongjin Coway annual earnings forecast

(Wbn)

		2010	2011	2012F	2013F	2014F
Rental orders (‘000 units)		1,167.4	1,272.5	1,265.7	1,323.9	1,324.2
Mthly avg cancellation rate (%)		1.07%	1.04%	0.99%	0.96%	0.96%
# of rental customer accounts (‘000)		4,145.1	4,450.0	4,751.0	5,035.7	5,289.8
# of membership accounts (‘000)		937.6	1,002.0	1,073.6	1,185.3	1,287.7
Total # of managed accounts (‘000)		5,082.7	5,452.0	5,824.6	6,221.0	6,577.4
Chg in total # of managed accounts (‘000)		346.4	369.3	372.6	396.4	356.4
Sales	Total	1,501.8	1,709.9	1,887.1	2,075.6	2,230.1
	Rental	1,106.3	1,206.3	1,305.7	1,387.6	1,460.4
	Membership	147.7	160.8	166.1	184.7	203.5
	Bullet payment	107.4	138.2	155.1	167.5	179.3
	Others	130.0	136.4	168.3	200.8	227.0
	Exports	69.2	98.1	125.9	151.7	174.5
	Water treatment	22.4	13.7	16.0	20.0	22.0
	Living and other	40.1	24.6	26.4	29.0	30.5
	Cosmetics	23.4	68.2	92.0	135.0	160.0
Sales growth (% yoy)	Total	6.4	13.9	10.4	10.0	7.4
	Rental	4.5	9.0	8.2	6.3	5.2
	Membership	7.1	8.8	3.3	11.2	10.1
	Bullet payment	36.6	28.7	12.2	8.0	7.0
	Others	-4.6	4.9	23.4	19.3	13.1
	Exports	24.1	41.7	28.3	20.5	15.0
	Water treatment	-16.3	-38.8	16.8	25.0	10.0
	Living and other	-25.4	-38.7	7.3	10.0	5.0
	Cosmetics		191.9	34.9	46.7	18.5
GP		1,011.3	1,157.9	1,289.7	1,418.4	1,526.2
	(% yoy)	6.3	14.5	11.4	10.0	7.6
OP		253.5	242.5	281.7	328.2	365.9
	(% yoy)	24.1	-4.4	16.2	16.5	11.5
Pretax profit		243.3	225.4	252.6	299.2	341.1
	(% yoy)	20.0	-7.4	12.1	18.4	14.0
NP		183.3	177.1	192.0	226.8	258.6
	(% yoy)	19.6	-3.4	8.4	18.1	14.0
EBITDA		447.1	439.1	487.1	541.5	594.2
	(% yoy)	14.5	-1.8	10.9	11.2	9.7
GP margin (%)		67.3	67.7	68.3	68.3	68.4
OP margin (%)		16.9	14.2	14.9	15.8	16.4
EBITDA margin (%)		29.8	25.7	25.8	26.1	26.6
Pretax margin (%)		16.2	13.2	13.4	14.4	15.3
NP margin (%)		12.2	10.4	10.2	10.9	11.6

Note: Figures for 2010 and beyond are based on IFRS (unconsolidated).

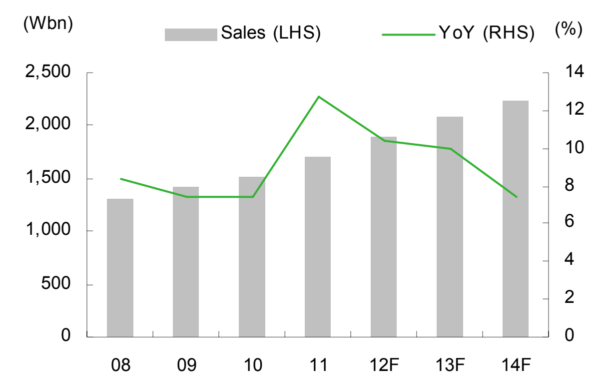
Source: Woongjin Coway, Daishin Securities Research Center

2012 OP margin is forecast to rise 0.7%p on a rise in rental accounts with sales commissions fully recognized and a reduction in losses from the cosmetics business

The margin outlook is positive for 2012. Woongjin Coway moved to IFRS reporting in 2011. Under IFRS, the sales commission recognition period for the rental orders placed in and after 2009 is reduced from five years to two. The result was a higher OP margin in 2010 and a lower OP margin in 2011, compared with K-GAAP. From 2012 onward, rental accounts with sales commissions fully recognized will rise as a percentage of total outstanding rental accounts, lifting rental margins. Margins may slow if an influx of new rental orders increases the base total, but even in this case, a margin slowdown can be offset by increased revenue with little impact on the bottom line.

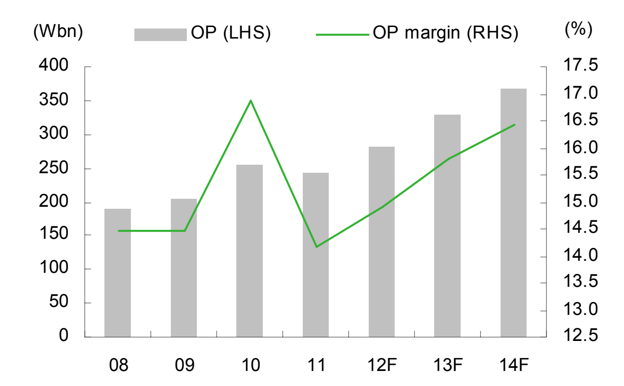
Meanwhile, the cosmetics business, which reported sales of W68bn and an operating loss of W19.5bn in 2011, will see sales surge 35% to W90bn in 2012 with the launch of “K-Line” featuring famous actress Hyun-jeong Koh as a follow-up brand to Allvit. The division's operating loss will diminish to W7bn, contributing to a 0.7%p overall OP margin improvement to 14.9%.

Fig 4. Sales forecast



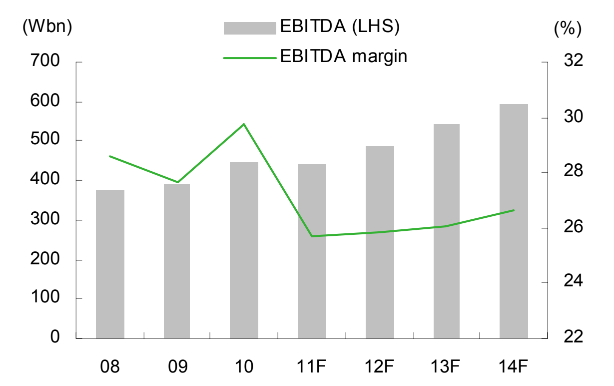
Note: Figures for 2011 and beyond are based on IFRS (unconsolidated; exclusive of equity method gains), while those for until 2010 are based on K-GAAP.
Source: Woongjin Coway, Daishin Securities Research Center

Fig 5. OP and OP margin forecasts



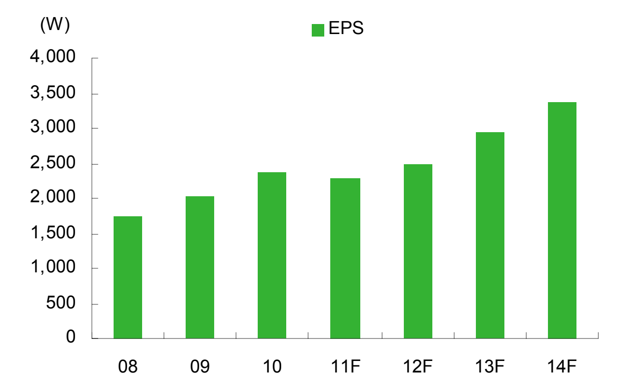
Note: Figures for 2011 and beyond are based on IFRS, while those for until 2010 are based on K-GAAP.
Source: Woongjin Coway, Daishin Securities Research Center

Fig 6. EBITDA and EBITDA margin forecasts



Note: Figures for 2010 and beyond are based on IFRS (unconsolidated).
Source: Woongjin Coway, Daishin Securities Research Center

Fig 7. EPS forecast



Note: Figures for 2010 and beyond are based on IFRS (unconsolidated).
Source: Woongjin Coway, Daishin Securities Research Center

A reversal to equity method gains is expected in 2012

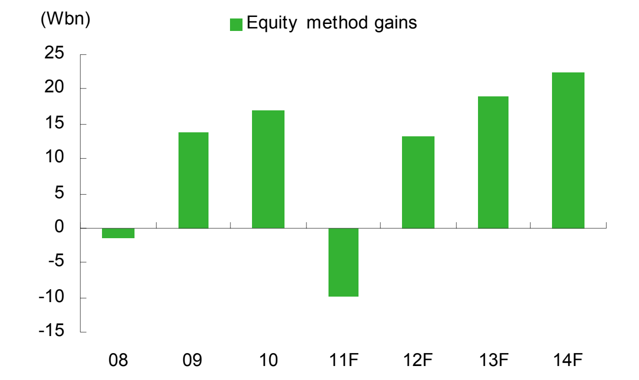
Woongjin Coway reports on an unconsolidated basis under IFRS without equity method gains or losses from Its Chinese subsidiary, which operates the environmental home appliances and cosmetics businesses, and Woongjin Chemical. Woongjin Chemical's NP sharply decreased from W60.3bn in 2010 to W4.0bn in 2011 due to poor market conditions, a heavier cost burden, and inventory disposal losses. Equity method losses from overseas subsidiaries are estimated to have widened to W9.8bn in 2011 after increased investments in Thailand and other countries.

A reversal to equity method gains is expected in 2012 as the Chinese subsidiary continues to hum along, Woongjin Chemical rebounds from a profit retreat, and the Malaysian subsidiary returns to profit. Specifically, 2012 equity method gains are forecast to reach W13.3bn, equivalent to EPS of W180, excluding treasury shares.

We expect similar payouts at a dividend payout ratio of about 40% going forward

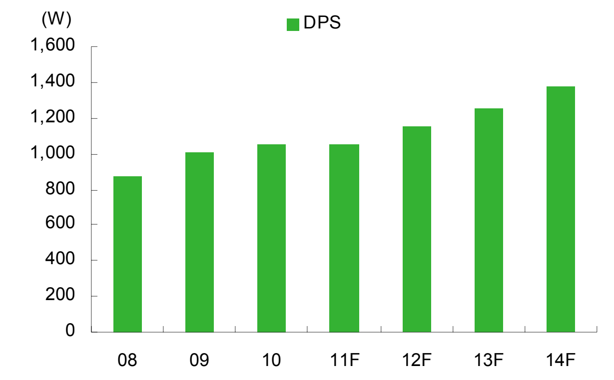
Woongjin Coway will pay a W1,050/share dividend for 2011, and we expect similar payouts at a dividend payout ratio of about 40% going forward, which may change, depending on who takes over the company.

Fig 8. Equity method gains forecast



Note: Figures for 2010 and beyond are based on IFRS; those for 2011 and beyond are our estimates. Source: Woongjin Coway, Daishin Securities Research Center

Fig 9. DPS forecast



Source: Woongjin Coway, Daishin Securities Research Center

III. Solid as a rock

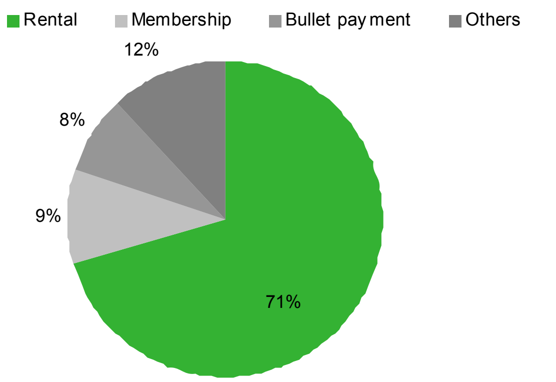
Strongly positioned in core markets

Korea's largest rental company; the majority of sales come from rental and membership services

Woongjin Coway is Korea's largest rental company deploying water dispensers, bidets, air cleaners, and other environmental home appliances. Its sales break down as follows: rental services under five-year contracts (70.5%), membership services based on full upfront payments (9.4%), single-payment sales (8.1%), and exports and cosmetics (12.0%).

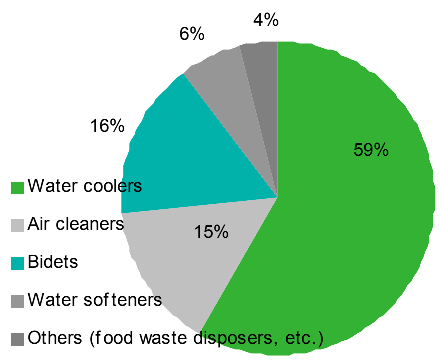
Its rental and membership services generate the largest portion of sales (58.4%) from water dispensers. Bidets (16.5%) and air cleaners (14.9%) are the next best-selling items. Others include mattresses (launched in 2011) and food waste disposers.

Fig 10. Sales breakdown by business division (2011)



Note: Others consist of exports, cosmetics, and water treatment.
Source: Woongjin Coway, Daishin Securities Research Center

Fig 11. Sales breakdown by product



Note: Based on the combined sales for rental services, membership services, and bullet payment. Source: Woongjin Coway, Daishin Securities Research Center

Woongjin Coway holds a wide lead over competitors

Within the rental market, Woongjin Coway has an unrivalled position. Chungho Nais is a distant second, and its rental sales and assets are 14.6% and 15.9% of Woongjin Coway's based on 2010 figures. The corresponding figures for Kyowon L&C, the third, are 6.2% and 11.3%, respectively. The gaps grow even wider when it comes to margins and cash flows. A Gallup Research poll conducted in 2H11 showed that Woongjin Coway's market shares stood at 54.7% for water dispensers, 46.9% for bidets, and 44.0% for air cleaners, well above the second-biggest competitor's (11.6%, 19.5%, and 12.5% each).

Customer defections from Woongjin Coway look unlikely.

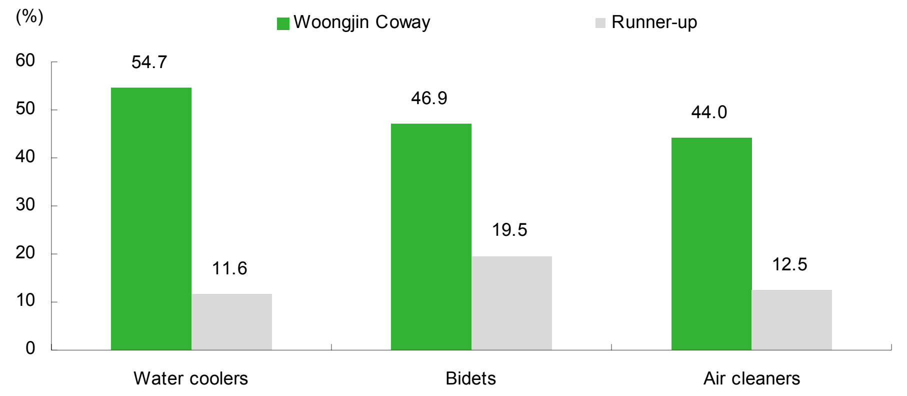
Smaller rental companies are ramping up rental business competition lately, but customer defections from Woongjin Coway look unlikely because underpricing strategies alone will not persuade Woongjin Coway's customers accustomed to premium services to switch brands. Health-conscious customers of environmental home appliances tend to have high brand loyalty.

Customer expectations and needs will diversify, and Woongjin Coway is well positioned to meet that trend

Competition from smaller rental companies will increase the market pie by luring new customers at low price points. Low-end customers will migrate toward the high end of the market over time, providing Woongjin Coway with a new source of long-term growth.

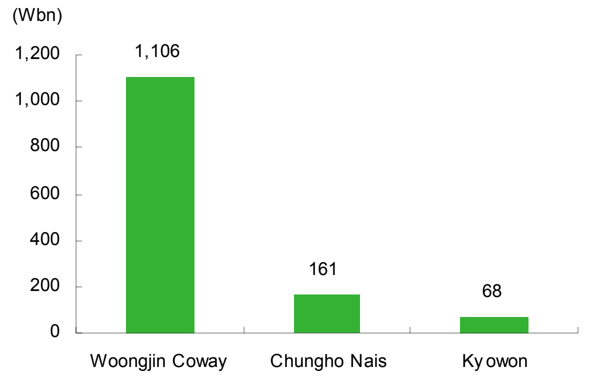
As the market base of environmental home appliances expands, customer expectations and needs will diversify, making constant product and service upgrades necessary. Woongjin Coway is well positioned to meet that trend because of its virtuous cycle of cash flows.

Fig 12. Market share comparison



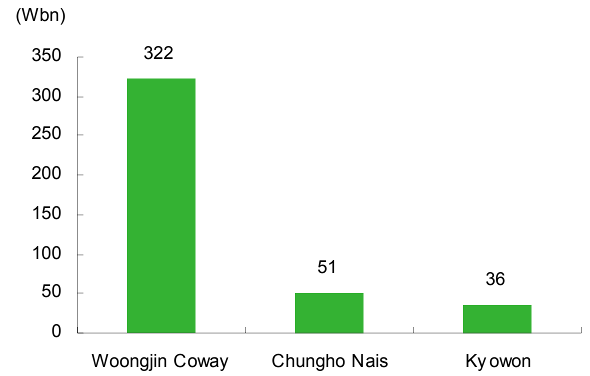
Note: Based on a 2H11 Gallup poll
Source: Woongjin Coway, Gallup Research

Fig 13. Rental sales at three major rental companies



Note: Excluding Woongjin Coway's membership customers
Source: Individual companies Daishin Securities Research Center

Fig 14. Rental assets at three major rental companies



Note: Excluding Woongjin Coway's membership customers
Source: Individual companies Daishin Securities Research Center

V. New businesses drive long-term growth

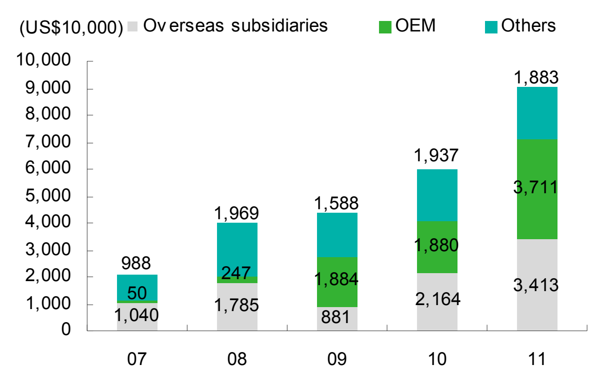
Export growth continues, and the cosmetics business looks set to turn a profit in 2013

Exports are the fastest growing segment

Exports account for only 5.7% of Woongjin Coway's total sales, but export sales are growing. Exports surged 42% to W98.1bn in 2011: overseas subsidiaries (38%), OEM (41%), and other sales (21%). OEM sales growth is now leading export growth. OEM sales of air cleaners to major home appliances makers such as Philips in China and India increased 97% in 2011 in dollar terms, and the trend will continue in 2012. In particular, China's demand for air cleaners will rise rapidly in line with rising income and increasing environmental awareness.

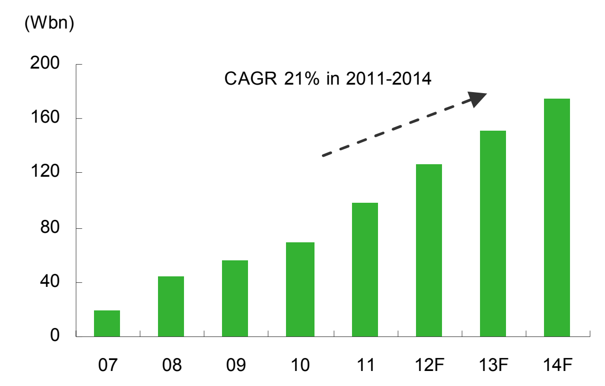
The company's subsidiaries in Malaysia and the US increased their sales 91% and 62%, respectively, in 2011, bringing sales growth at overseas subsidiaries to 58% in dollar terms. Export sales are forecast to expand 28% in 2012 and rise 21% annually on average for the next three years, driven by OEM sales and overseas subsidiaries' sales.

Fig 15. Export sales breakdown



Source: Woongjin Coway, Daishin Securities Research Center

Fig 16. Export sales forecast



Source: Woongjin Coway, Daishin Securities Research Center

Cosmetics business growth continues

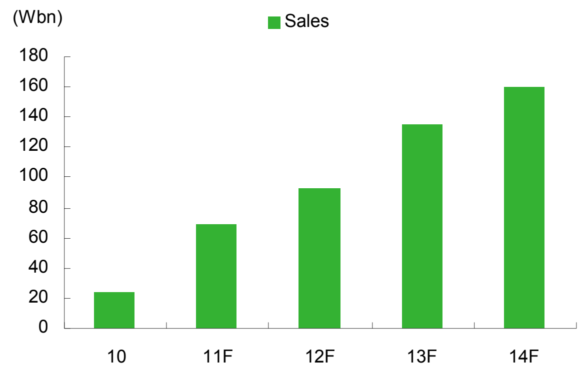
Woongjin Coway launched cosmetics door-to-door sales operations in September 2010. The cosmetics division registered an operating loss of W13.bn on sales of W23.4bn in 2010 and a W19.5bn operating loss on sales of W68.0bn in 2011. Excluding the cosmetics division, Woongjin Coway's 2011 OP margin would have come in at 16.0% or 1.8%p higher.

The cosmetics division has yet to make money, but early sales growth looks positive. The company is extending its reach to department stores and duty-free shops to increase its brand awareness, while continuing to beef up its product line-up including Hyun-jeong Koh's cosmetics line.

The cosmetics division will continue incurring heavy marketing expenses in the brand start-up stage

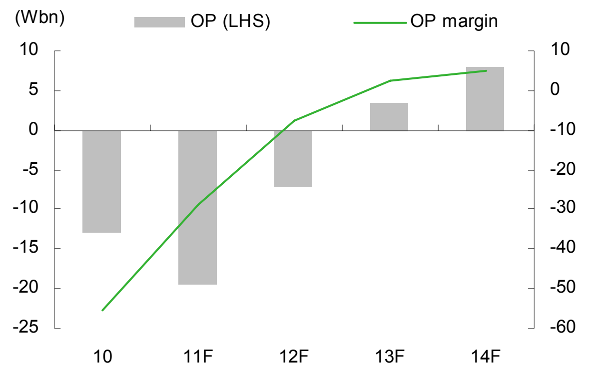
The cosmetics division is targeting sales of W100bn and the first operating profit in 2012. Our conservative forecasts are sales of W90bn and an operating loss of W7.0bn for 2012 and sales of W135.0bn and an OP of W3.4bn for 2013. The division will continue incurring heavy marketing expenses in the brand start-up stage.

Fig 17. Cosmetics division sales forecast



Source: Woongjin Coway, Daishin Securities Research Center

Fig 18. Cosmetics division OP forecast

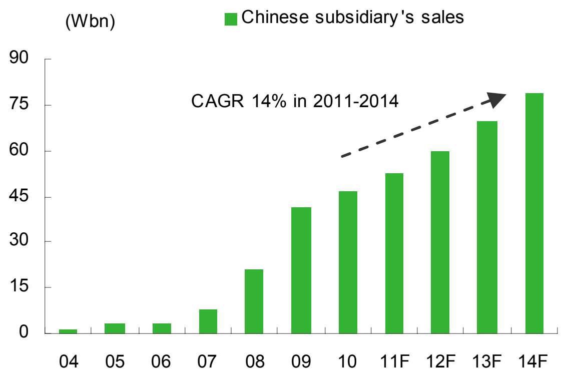


Source: Woongjin Coway, Daishin Securities Research Center

Chinese subsidiary's cosmetics business is going smoothly; sales are projected to increase at a 3-year CAGR of 14%

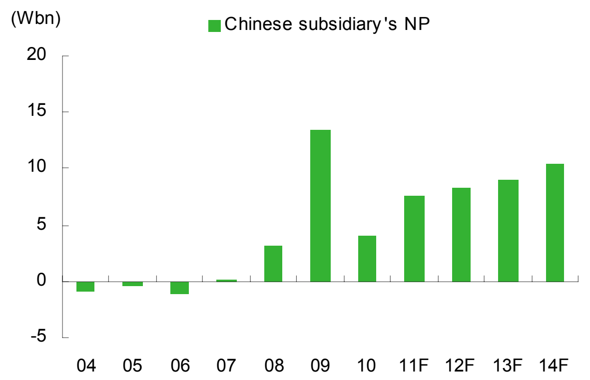
Woongjin Coway's wholly-owned Chinese subsidiary, which focuses on cosmetics, posted solid results in 2011 with sales up 14% to RMY309mn with an OP margin of 23%. The sales growth came despite consolidation of small stores and poorly performing brands. China sales are forecast to increase 14% annually on average over the next three years with the ramp-up of direct sales and increased regional coverage. Meanwhile, NP is forecast to grow at a 3-year CAGR of 12% with the full tax rate of 25% kicking in from 2013.

Fig 19. Chinese subsidiary sales forecast



Source: Woongjin Coway, Daishin Securities Research Center

Fig 20. Chinese subsidiary NP forecast



Source: Woongjin Coway, Daishin Securities Research Center

VI. Sale uncertainty is not much of a risk

Our take on Woongjin Holdings' sale of Woongjin Coway

Exit is inevitable

1. Why

At the end of 3Q11, Woongjin Holdings' debt stood at W900bn. Debt will likely grow further to meet construction and solar business investment and working capital needs. Dividend income from Woongjin Coway (assuming a 50% payout) will not be enough to cover the cost, given Woongjin Holdings' 28% stake.

Selling a portion of the stake can only hurt the value of Woongjin Coway. Therefore, Woongjin Holdings has no choice but to offload the entire stake. Now, Woongjin Holdings has to find a buyer that offers the best price.

Woongjin Holdings may or may not acquire Woongjin Coway's non-core assets and subsidiaries

2. What

A 30.8% stake including shareholdings owned by other major shareholders will be put up for sale. Woongjin Holdings will acquire Woongjin Coway's businesses other than environmental home appliances, including the domestic cosmetics business and water treatment business and subsidiaries (the Chinese subsidiary, Green Entech, and Woongjin Chemical), though even that could change.

Woongjin Holdings' acquisition of Woongjin Coway's non-core businesses is aimed at maximizing Woongjin Coway's value and making it more saleable. If the buyer wants all of Woongjin Coway, Woongjin Holdings will likely give up all of the company.

Impact on earnings will be minimal

3. Impact on Woongjin Coway's earnings

The earnings impact on Woongjin Coway's existing businesses will be limited. Currently, Woongjin Holdings generates sales of about W100bn (OP margin: 10%) from Woongjin Coway, which include brand royalties, MRO, call center revenue, and advisory service fees. Similarly, Woongjin Coway gets sales of W100bn (OP margin: 10%) from Woongjin Holdings' other subsidiaries.

Woongjin Coway's intra-company transactions worth W175bn (except for the W25.0bn it spends to purchase filters from Woongjin Chemical) means potential cost savings. Woongjin Coway has operational claims on all of its assets and patents.

A sales force loss may result and looks unlikely, given Woongjin Coway's industry-leading customer base, product quality and brand power. Moreover, a sales force restructuring is unlikely because a sales force is an important intangible asset to the buyer.

Woongjin Coway is an attractive acquisition target for consumer goods manufacturers

4. Who

Woongjin Coway is an attractive acquisition target for consumer goods manufacturers: 1) Woongjin Coway has 2.8mn middle-class consumers as its customers, and 80% of its customers are repeat customers; 2) Woongjin Coway has a strong door-to-door sales force; and 3) Woongjin Coway's strong brand loyalty allows it to sell high-priced products to existing customers. The company's well-established business model means it is better suited for established manufacturers than for investment funds seeking restructuring premiums.

Financial investors seeking dividend income may express interest in holding a stake in Woongjin Coway. Foreign consumer goods companies seeking an established local distribution network could also find Woongjin Coway attractive.

5. Price

The stake sale will be priced at a little over W1.2tn if a 30% premium is added

The stake sale will be priced at a little over W1.2tn if a 30% premium is added to the current share price level. That is equivalent to 20x 2012E NP. A DCF valuation suggests a higher price, given Woongjin Coway's excellent cash flow

.

Strong cash flows and the low cost burden keep the door open to future growth opportunities

The nature of the rental business requires considerable amounts of working capital and time in the start-up stage. When more accounts pass the break-even point, the cash flow improves rapidly and operating leverage increases because much of the upkeep cost is variable costs. Woongjin Coway has achieved this virtuous cycle of cash flows. Coupled with its large door-to-door sales force that comes in direct contact with middle- and upper-income customers, it keeps the door open to future growth opportunities.

Woongjin Coway has maintained a high dividend payout ratio of 40-50% with occasional share buybacks. Under new ownership, the company will be able to spend more money on business growth based on synergy.

[Financial statements]

Income statement

(Wbn)

	2010A	2011A	2012F	2013F	2014F
Sales	1,502	1,710	1,887	2,076	2,230
Cost of goods sold	491	552	597	657	704
Gross profit	1,011	1,158	1,290	1,418	1,526
Other operating income	651	822	914	993	1,057
SG&A expenses	704	869	961	1,042	1,109
FX transaction income	0	0	0	0	0
Interest income	0	0	0	0	0
Other one-off income	-53	-46	-47	-49	-52
Operating profit	254	242	282	328	366
Adjusted OP	307	289	328	377	418
EBITDA	461	439	487	541	594
Non-OP	11	-17	-29	-29	-25
Income from affiliates	22	0	0	0	0
Financial revenue	7	2	0	0	0
Financial expenses	-18	-27	-34	-34	-31
Others	0	8	5	5	6
Income before taxes	243	225	253	299	341
Income tax expense	-60	-48	-61	-72	-83
Income from cont. op.	177	177	192	227	259
Income from discont. op.	0	0	0	0	0
Net income	183	177	192	227	259
NP for non-contr. interest	0	0	0	0	0
NP for contr. interest	177	177	192	227	259
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	0	0	0	0	0
Comprehensive income	147	172	192	227	259
Comp. income for non-contr. Int.	0	0	0	0	0
Comp. income for contr. int.	0	0	0	0	0

Note: Adjusted OP is GP less SG&A expense.

Balance sheet

(Wbn)

	2010A	2011A	2012F	2013F	2014F
Current assets	439	526	586	616	597
Cash & cash equiv.	56	52	92	86	48
Trade & other receive.	223	241	263	289	311
Inventories	73	83	92	101	109
Other current assets	86	150	140	140	130
Long-term assets	925	1,051	1,161	1,278	1,367
Tangible assets	442	568	676	782	857
Investments in affiliates	192	224	224	224	224
Other financial assets	3	6	11	19	36
Other long-term assets	288	253	250	252	251
Total assets	1,364	1,578	1,747	1,894	1,964
Current liabilities	384	529	532	609	582
Payables & other liab.	182	174	182	190	194
Borrowings	74	164	159	149	129
Debt liquidity	30	100	90	159	140
Other current liabilities	98	91	101	111	119
Long-term liabilities	247	299	351	279	211
Borrowings	220	279	329	255	185
Convertible securities	0	0	0	0	0
Other long-term liab.	27	20	22	25	26
Total liabilities	631	828	884	888	793
Controlling interest	733	750	864	1,005	1,171
Capital stock (Com.)	41	41	41	41	41
Capital surplus	136	129	129	129	129
Retained earnings	591	688	802	944	1,110
Other capital changes	-34	-108	-108	-108	-108
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	733	750	864	1,005	1,171
Total borrowings	324	543	578	563	454

Valuation metrics

(W, x, %)

	2010A	2011A	2012F	2013F	2014F
EPS	2,376	2,296	2,490	2,941	3,353
PER	17.0	15.9	14.7	12.4	10.9
BPS	9,504	9,719	11,199	13,035	15,186
PBR	4.2	3.8	3.3	2.8	2.4
EBITDAPS	5,973	5,686	6,313	7,019	7,701
EV/EBITDA	7.3	7.6	6.8	6.1	5.4
SPS	19,472	22,170	24,469	26,913	28,915
PSR	2.1	1.7	1.5	1.4	1.3
CFPS	5,065	6,197	6,746	7,437	8,088
DPS	1,050	1,050	1,150	1,250	1,375

Financial ratios

(W, x, %)

	2010A	2011A	2012F	2013F	2014F
Growth potential					
Sales growth	6.4	13.9	10.4	10.0	7.4
OP growth	24.1	-4.4	16.2	16.5	11.5
NP growth	19.6	-3.4	8.4	18.1	14.0
Profitability					
ROIC	20.7	18.5	19.6	20.7	21.3
ROA	19.2	16.5	16.9	18.0	19.0
ROE	25.9	23.9	23.8	24.3	23.8
Stability					
Debt ratio	86.1	110.5	102.3	88.4	67.7
Net borrowings ratio	36.4	65.5	56.3	47.5	34.7
Interest coverage ratio	14.4	9.2	8.3	9.6	11.9

Cash flow statement

(Wbn)

	2010A	2011A	2012F	2013F	2014F
Operating cash flows	314	377	410	448	490
Net income	177	177	192	227	259
Non-cash items	207	301	328	347	365
Depreciation	263	284	303	317	341
FX gains	0	2	0	0	0
Equity method gain	-22	0	0	0	0
Others	-33	15	25	30	24
Chg in assets & liab.	-71	-81	-84	-88	-82
Other cash flows	0	-20	-27	-38	-52
Investing cash flow	-296	-304	-265	-275	-263
Investments	-65	-35	-5	-9	-16
Others				-212	-269
Others	-19	-1	-1	-1	-1
Financing cash flows	-20	215	-41	-98	-200
Short-term borrowings	-45	90	-5	-10	-20
Bonds payable	50	129	50	-64	0
Long-term borrowings	100	-70	0	-10	-70
Rights offering	0	0	0	0	0
Cash dividends	-77	-80	-78	-85	-93
Others	-48	146	-8	71	-17
Net chg in cash	-7	-4	40	-6	-38
Beginning cash balance	64	56	52	92	86
Ending cash balance	56	52	92	86	48
NOPLAT	191	191	214	249	277
FCF	107	60	102	143	204

Source: Woongjin Coway, Daishin Securities Research Center

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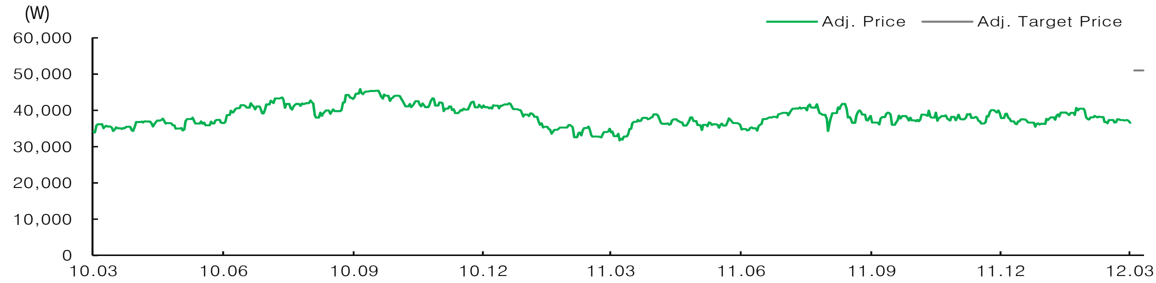
Ratings and target price history



Date	12.03.12					
Rating	Buy					
TP	51,000					
Date						
Rating						
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Date						
Rating						
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Investment ratings

Sector ratings breakdown

- Overweight: industry indicators are expected to outperform the market over the next six months.
- Neutral: industry indicators are expected to be in line with the market over the next six months.
- Underweight: industry indicators are expected to underperform the market over the next six months.

Company ratings breakdown

- Buy: the stock is expected to outperform the market by at least 10%p over the next six months.
- Marketperform: the stock is expected to either outperform or underperform the market by less than 10%p over the next six months.
- Underperform: the stock is expected to underperform the market by at least 10%p over the next six months.