

Coway  
(021240)

“ 4Q12 results should not be bad; earnings and financial structures should improve in 2013 ”



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## Investment points

- 4Q12 OP should rise insignificantly relative to sales due to increased loss on abandonment of newly launched mini-size rental properties
- In 2013, earnings and financial structures should improve
- BUY and 6M TP of W51,000 reiterated; dividends should be paid out twice in 2013

## Comment

4Q12 sales and OP should expand 5.6% and 1.1% yoy, respectively, to W469.1bn and W63.5bn

4Q12 sales are predicted to expand 5.6% yoy to W469.1bn as rental, membership, and bullet payment sales balloon 4.6%, 3.3%, and 9.7%, respectively. But OP is forecasted to rise only 1.1% yoy to W63.5bn due to greater-than-usual losses on abandonment of rental properties as some of the recently introduced miniature water purifiers are being returned within the first 14 days of purchase due to functional defects. Of note, the loss on abandonment of rental properties will fall back to the average level in 2013 as most of those defects resulting from the process of making rental products smaller are resolved during 4Q12. Meanwhile, earnings would temporarily plunge if Coway decides to pay compensation bonuses to its employees for company sell-off, although it is uncertain whether and how large bonuses will be paid.

2013 OP and NP should climb 13% and 68%, respectively; proceeds from Wongjin Chemical sale will be used to pay off borrowings

2013 sales are predicted to balloon 5.7% yoy, despite domestic economic weakness, as 1) the number of rental accounts already increased; 2) a widened range of new products lead to strong influx of new orders; and 3) membership customers for mattresses, etc. increase. In addition, rental prices could rise in 2013, as Coway has not raised them since 2009 (usually, it increases rental prices in every three years).

Meanwhile, 2013 OP margin is forecasted to go up 1.0%p yoy to 14.9%, as 1) loss on abandonment of rental properties falls back to normal; 2) costs drop by about W10bn due to adjustments of approximately W200bn-worth purchase contracts with Woongjin Group affiliates; and 3) stricter control is applied to various SG&A expenses.

In 1Q13, Coway will likely generate a W44.9bn gain on sale of its stake in Woongjin Chemical. The sale proceeds of W178.2bn will be used to pay off borrowings, reducing them by W167.3bn (considering the corporate tax levied on the gain). Coway is also considering selling off its two water treatment subsidiaries (combined book value: W35bn), in which case the company would be able to pay off more borrowings.

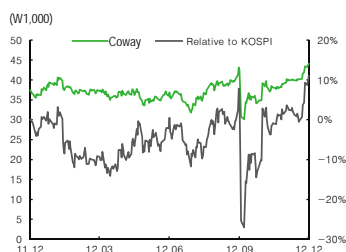
**BUY**  
[maintain]  
Other services

CP W44,100

6M TP  
(maintained) **W51,000**

KOSPI	1982.25
Market cap (Wbn)	3,401
Market cap portion (%)	0.3
Paid-in capital (common; Wbn)	41
52w high/low (W)	44,100 / 30,150
120d avg. trading volume (Wbn)	6.6
Foreign ownership (%)	51.3
Major shareholders	
	Coway Holdings 30.9%

(%)	1W	1M	3M	12M
Abs. return	6.0	12.1	3.8	17.8
Rel. return	6.6	7.9	3.7	10.3



**BUY and 6M TP of W51,000 maintained; there will likely be two dividend payouts in 2013**

Coway will not pay out dividends at the end of 2012. Instead, it is predicted to pay out W1,050/share in dividend at the end of March 2013. And another dividend payout is expected at the end of 2013. We reiterate our BUY rating and the six-month target price of W51,000 on Coway, which is displaying stable mid-single-digit growth despite economic downturns and whose earnings and financial structures are projected to improve in 2013.

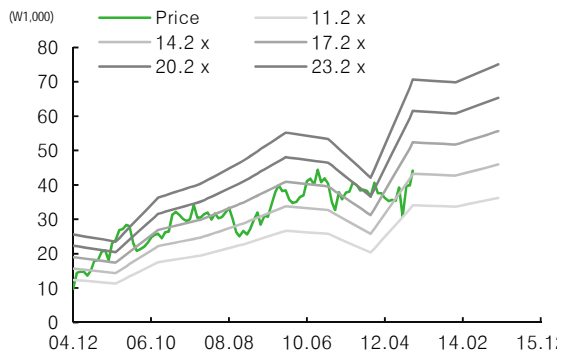
Tab 1. Coway's quarterly earnings forecast

(Wbn, %)

	1Q12	2Q12	3Q12	4Q12F	1Q13F	2Q13F	3Q13F	4Q13F	2011	2012F	2013F	2014F
Rental orders ('000)	284.7	331.1	293.5	290.9	301.5	339.8	334.9	333.1	1,265.2	1,200.2	1,309.3	1,333.9
Monthly cancellation rate (%)	1.01	1.01	1.01	0.95	0.95	0.93	0.95	0.95	1.04	1.00	0.95	0.96
Rental accounts ('000)	4,462.9	4,488.9	4,512.1	4,538.5	4,554.0	4,608.7	4,695.9	4,763.6	4,450.0	4,577.6	4,802.7	5,028.0
Membership accounts	1,003.6	1,082.1	1,118.5	1,158.9	1,201.8	1,248.6	1,276.5	1,310.0	1,002.0	1,158.9	1,310.0	1,466.8
Total customer accounts	5,466.6	5,571.0	5,630.6	5,697.4	5,755.7	5,857.3	5,972.4	6,073.6	5,452.0	5,736.6	6,112.7	6,494.8
Chg in total customer accts.	21.8	104.4	59.6	66.9	58.3	101.5	115.1	101.2	369.3	284.5	376.1	382.1
Sales												
Total	442.4	446.4	458.0	469.1	466.8	468.2	484.4	499.4	1,709.9	1,815.9	1,918.7	2,059.2
Rental	316.3	318.9	323.2	327.3	330.4	334.3	340.2	346.5	1,206.3	1,285.7	1,351.4	1,434.1
Membership	38.8	39.2	41.1	42.1	43.2	44.5	45.5	46.4	160.8	161.2	179.5	195.6
Bullet payment	32.7	40.5	39.1	35.0	36.0	43.0	41.5	37.9	138.2	147.3	158.4	173.2
Others	37.8	31.5	37.4	46.6	39.5	29.2	38.2	48.9	137.5	153.3	155.7	176.9
Cosmetics	16.8	16.3	17.3	18.0	17.6	17.2	19.0	19.8	68.2	68.4	73.6	79.5
YoY (%)												
Total	10.3	2.4	6.5	5.6	5.5	4.9	5.8	6.5	13.9	6.2	5.7	7.3
Rental	9.8	6.4	5.7	4.6	4.5	4.8	5.3	5.9	9.0	6.6	5.1	6.1
Membership	(0.8)	(1.9)	0.3	3.3	11.5	13.5	10.7	10.0	8.8	0.3	11.4	8.9
Bullet payment	2.8	4.4	9.5	9.7	10.0	6.2	6.3	8.2	28.7	6.6	7.6	9.3
Others	53.6	(20.4)	23.9	8.2	4.5	(7.2)	2.2	4.8	5.8	11.5	1.6	13.6
Cosmetics	(3.3)	(8.8)	(1.7)	17.4	5.0	5.0	10.0	10.0	191.9	0.3	7.6	8.0
GP	296.9	304.3	306.5	313.8	314.6	320.7	328.4	334.5	1,157.9	1,221.5	1,298.2	1,395.7
OP	64.4	63.0	62.0	63.5	67.7	68.2	74.5	76.1	242.5	252.9	286.5	320.4
Pretax profit	55.6	56.4	17.7	54.8	105.5	64.1	69.3	70.5	225.4	184.5	309.3	305.7
NP	41.2	44.0	12.9	41.5	80.0	48.6	52.5	53.4	177.1	139.7	234.5	231.7
EBITDA	119.5	115.7	126.4	120.4	110.4	110.9	117.2	118.8	439.9	482.0	510.4	547.3
YoY (%)												
GP	8.2	3.3	3.8	6.9	6.0	5.4	7.1	6.6	14.5	5.5	6.3	7.5
OP	14.0	2.0	1.0	1.1	5.2	8.2	20.2	19.8	(4.4)	4.3	13.3	11.8
Pretax profit	10.3	2.5	(72.6)	(0.8)	89.7	13.6	291.6	28.6	(7.4)	(18.1)	67.7	(1.2)
NP	6.4	4.6	(73.7)	(11.8)	93.9	10.3	306.9	28.6	(3.3)	(21.1)	67.9	(1.2)
EBITDA	14.3	4.8	13.4	6.2	(7.6)	(4.2)	(7.2)	(1.4)	1.6	9.6	5.9	7.2
GP margin (%)	67.1	68.2	66.9	66.9	67.4	68.5	67.8	67.0	67.7	67.3	67.7	67.8
OP margin (%)	14.6	14.1	13.5	13.5	14.5	14.6	15.4	15.2	14.2	13.9	14.9	15.6
Pretax margin (%)	12.6	12.6	3.9	11.7	22.6	13.7	14.3	14.1	13.2	10.2	16.1	14.8
NP margin (%)	9.3	9.9	2.8	8.9	17.1	10.4	10.8	10.7	10.4	7.7	12.2	11.3
EBITDA margin (%)	27.0	25.9	27.6	25.7	23.7	23.7	24.2	23.8	25.7	26.5	26.6	26.6

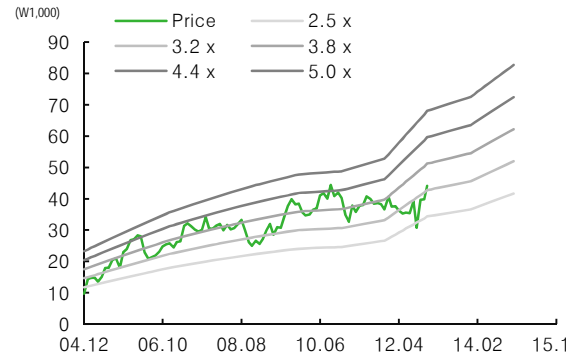
Source: Daishin Securities Research Center

Fig 1. 12M Fwd P/E band



Source: WISEfn, Daishin Securities Research Center

Fig 2. 12M Fwd P/B band



Source: WISEfn, Daishin Securities Research Center

## [Financial statements]

Income statement	(Wbn)				
	2010A	2011A	2012F	2013F	2014F
Sales	1,502	1,710	1,816	1,919	2,059
Cost of goods sold	491	552	594	621	664
Gross profit	1,011	1,158	1,222	1,298	1,396
Other operating income	651	823	829	908	966
SG&A expenses	704	869	899	960	1,021
FX transaction income	0	0	0	0	0
Interest income	0	0	0	0	0
Other one-off income	-53	-46	-70	-52	-55
Operating profit	254	242	253	287	320
Adjusted OP	307	289	323	338	375
EBITDA	461	441	490	509	546
Non-OP	11	-17	-68	23	-15
Income from affiliates	22	0	-3	0	0
Financial revenue	7	2	3	3	3
Financial expenses	-18	-26	-67	-26	-20
Others	0	6	-1	46	2
Income before taxes	243	225	185	309	306
Income tax expense	-60	-48	-45	-75	-74
Income from cont. op.	177	177	140	234	232
Income from discount. op.	0	0	0	0	0
Net income	183	177	140	234	232
NP for non-contr. interest	0	0	0	0	0
NP for contr. interest	177	177	140	234	232
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	0	0	0	0	0
Comprehensive income	147	173	138	234	232
Comp. income for non-contr. Int.	0	0	0	0	0
Comp. income for contr. int.	0	173	0	0	0

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

Valuation metrics	(W, x, %)				
	2010A	2011A	2012F	2013F	2014F
EPS	2,376	2,296	1,811	3,040	3,004
PER	17.0	15.9	24.3	14.5	14.7
BPS	9,504	9,704	10,506	13,546	14,426
PBR	4.2	3.8	4.2	3.3	3.1
EBITDAPS	5,973	5,720	6,351	6,599	7,077
EV/EBITDA	7.3	7.5	8.0	7.1	6.7
SPS	19,472	22,170	23,545	24,878	26,700
PSR	2.1	1.7	1.7	1.6	1.5
CFPS	5,065	6,108	5,233	6,271	6,732
DPS	1,050	1,050	0	2,200	1,250

Financial ratios	(W, x, %)				
	2010A	2011A	2012F	2013F	2014F
<b>Growth potential</b>					
Sales growth	6.4	13.9	6.2	5.7	7.3
OP growth	24.1	-4.4	4.3	13.3	11.8
NP growth	19.6	-3.4	-21.1	67.8	-1.2
<b>Profitability</b>					
ROIC	20.7	18.7	18.1	18.8	19.5
ROA	19.2	16.5	15.7	16.6	18.0
ROE	25.9	23.9	17.9	25.3	21.5
<b>Stability</b>					
Debt ratio	86.1	110.6	103.2	73.2	57.3
Net borrowings ratio	36.4	62.5	61.5	21.7	22.6
Interest coverage ratio	14.4	9.6	8.6	11.1	16.0

Balance sheet	(Wbn)				
	2010A	2011A	2012F	2013F	2014F
Current assets	439	511	471	678	531
Cash & cash equiv.	56	65	29	218	53
Trade & other receive.	223	257	262	277	287
Inventories	73	73	61	64	69
Other current assets	86	117	119	120	122
Long-term assets	925	1,065	1,175	1,131	1,219
Tangible assets	442	535	646	736	821
Investments in affiliates	192	237	237	103	103
Other financial assets	3	48	47	47	47
Other long-term assets	288	245	245	245	247
Total assets	1,364	1,576	1,646	1,810	1,750
Current liabilities	384	534	637	615	515
Payables & other liab.	182	187	181	186	188
Borrowings	74	165	230	220	210
Debt liquidity	30	110	150	129	30
Other current liabilities	98	72	77	81	87
Long-term liabilities	247	294	199	149	123
Borrowings	220	267	157	105	75
Convertible securities	0	0	0	0	0
Other long-term liab.	27	27	42	44	47
Total liabilities	631	828	836	765	637
Controlling interest	733	748	810	1,045	1,113
Capital stock (Com.)	41	41	41	41	41
Capital surplus	136	131	131	131	131
Retained earnings	591	678	740	974	1,042
Other capital changes	-34	-101	-101	-101	-101
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	733	748	810	1,045	1,113
Total borrowings	324	542	537	454	315

Cash flow statement	(Wbn)				
	2010A	2011A	2012F	2013F	2014F
Operating cash flows	314	318	341	362	396
Net income	177	177	140	234	232
Non-cash items	207	294	264	249	287
Depreciation	154	152	167	171	171
FX gains	0	1	1	0	0
Equity method gain	-22	0	0	0	0
Others	76	140	96	78	117
Chg in assets & liab.	-71	-112	-48	-74	-70
Other cash flows	0	-42	-14	-49	-53
Investing cash flow	-296	-344	-275	-126	-255
Investments	-65	-37	1	134	0
Tangible assets	-212	-290	-271	-255	-250
Others	-19	-16	-5	-5	-5
Financing cash flows	-20	36	-107	-184	-249
Short-term borrowings	-45	90	65	-10	-10
Bonds payable	50	123	-50	-52	0
Long-term borrowings	100	30	-60	0	-30
Rights offering	0	0	0	0	0
Cash dividends	-77	-80	-78	-78	-86
Others	-48	-127	16	-45	-123
Net chg in cash	-7	8	-36	189	-165
Beginning cash balance	64	56	65	29	218
Ending cash balance	56	65	29	218	53
NOPLAT	191	191	191	217	243
FCF	107	37	79	123	154

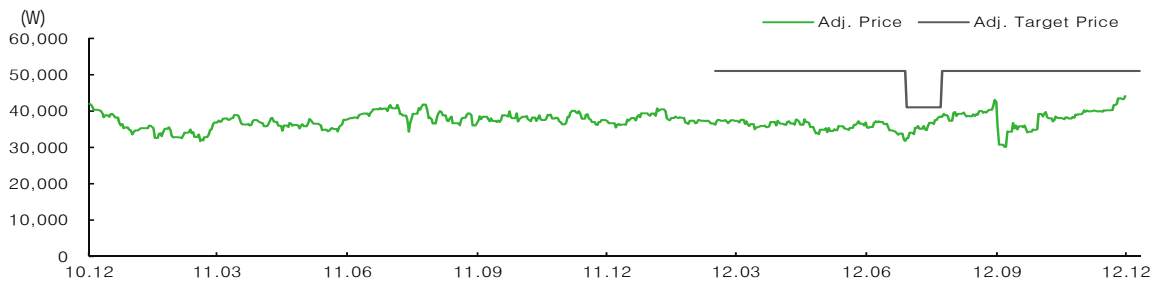
Source: Coway, Daishin Securities Research Center

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### ► Rating and target price history



Date	12.12.27	12.10.26	12.10.07	12.08.19	12.08.09	12.07.25	12.06.22	12.03.12
Rating	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy
TP	51,000	51,000	51,000	51,000	41,000	41,000	51,000	51,000
Date								
Rating								
TP								
Date								
Rating								
TP								

### ► Investment ratings framework

#### 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.