

Coway (021240)

Above
In line
Below

12M rating **BUY (Upgrade)**

12M TP **W56,000**

Up/downside **+18%**

Stock Data

KOSPI (Feb 15, pt)	1,981
Stock price (Feb 15, KRW)	47,400
Market cap (USD mn)	3,390
Shares outstanding (mn)	77
52-Week high/low (KRW)	47,400/30,150
6M avg. daily turnover (USD mn)	8.4
Free float / Foreign ownership (%)	65.8/51.4
Major shareholders (%)	
Coway Holdings, Inc. and 1 others	30.9
Lazard Asset Management LLC and 36 others	14.5

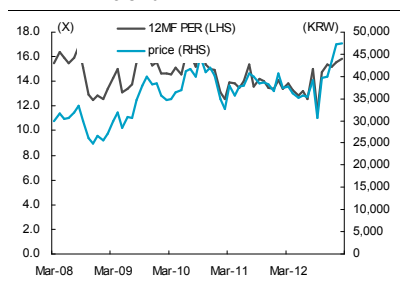
Valuation

	2011A	2012F	2013F
PER (x)	16.4	25.9	14.5
PBR (x)	3.3	3.7	3.4
ROE (%)	22.2	16.2	27.4
EV/EBITDA (x)	8.1	9.4	8.1
EPS (KRW)	2,235	1,682	3,278
BPS (KRW)	10,962	11,837	14,084

Performance

	1M	6M	12M
Absolute (%)	7.7	26.2	24.4
Relative to KOSPI (%p)	7.9	25.0	26.6

12MF PER trend



Source: WISEfn consensus

Stability amid uncertain market conditions; Change underway from 2013

What's new: OP weak on increase one-off costs

4Q12 OP fell 43% YoY, well short of consensus, despite sales improving 3.6% YoY. We attribute the low OPM of 8.3% to: 1) conservative accounting, including W11.8bn in disposal costs for outdated inventories, and 2) long-term bonuses of W15.6bn. Stripping out these one-offs, OP would have reached W63.1bn, in line with the W63.2bn recorded in 2011. Meanwhile, rental accounts grew 5.3% to 5.74mn by yearend (70,000 net additions in 4Q12) on increased air purifier, bidet and mattress borrowers, despite the uncertain market conditions. Rental ARPU also increased 1.6% YoY.

Pros: Stable earnings as leading player; positive catalysts likely

2012 sales and OP (excluding one-off costs) rose about 5%, confirming earnings stability and upside. Coway has a dominant share in core markets, such as water purifiers and air purifiers (50%), and the rental/membership business weighting is as high as 81%, ensuring stable cash flows. Earnings visibility is high as rental/membership prices are applied for five years. Meanwhile, positive catalysts are on the way. First, we expect more aggressive operations in the environmental market following an M&A and fading group-related risks from 2012, including workforce expansion for the domestic and overseas cosmetics businesses. Second, business restructuring should accelerate. In fact, expansion into the high-margin homecare business is gaining traction. And, the disposal of the unprofitable water treatment business is underway with the sale of Woongjin Chemical. Third, rental/membership ASP may be raised as there have been no price hikes for five years. Pricing power should come to the fore amid a weak market. As such, we forecast 2013 OP will surge 29% YoY (15% YoY excluding 2012 one-off costs) on steady growth in environmental appliances and lower cosmetics losses.

Cons: Core business growth slowing, management needs to confirm operating strength in 2013

Net subscriber growth slowed from 369,000 in 2011 to 289,000 in 2012. And, water purifier sales were sluggish in 4Q12. Given the mature water purifier market, Coway is looking for new growth engines in homecare, such as mattresses. Management needs to confirm the company's operating strength in 2013, and secure mid to long-term growth engines.

(W bn, %, %p)

	4Q12P				Change		2013F	
	KIS est.	Actual	Diff.	Consensus	QoQ	YoY	KIS	Consensus
Sales	504.0	460.1	(8.7)	484.7	0.4	3.6	1,914.0	2,011.2
OP	71.6	35.7	(50.2)	63.4	(43.3)	(43.6)	294.8	298.4
OP margin	14.2	7.7	(6.5)	13.1	(5.8)	(8.8)	15.4	14.8
EBT	67.0	31.7	(52.6)	60.4	79.3	(42.5)	316.2	315.3
NP	53.8	21.6	(59.9)	45.9	67.2	(54.2)	239.7	241.0

Conclusion: Upgrade to BUY, Coway to reinforce position as environmental appliance and homecare service specialist

Coway is trading at a premium to the market at 14.5x 12MF PE as the acquisition by MBK Partners eased governance risks. While positive expectations have already been priced in, we believe shares still offer upside given a historical PE band of 12-20x. We upgrade Coway to BUY with a TP of W56,000 (17.3x 12MF PE, five-year trailing average) given the earnings stability amid unfavorable market conditions and positive catalysts from accelerating business restructuring.

Table 1. Earnings breakdown

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12P
Total account growth (QoQ)	62.9	64.6	69.1	149.8	118.2	131.7	78.4	41.0	31.6	116.1	70.0	70.8
Rental ARPU (%YoY)	-0.6	-0.3	-0.1	0.4	1.0	2.4	3.4	3.6	4.3	3.2	2.1	1.6
Membership ARPU (%YoY)	-2.3	1.0	-1.9	-2.6	-1.9	-3.0	-3.8	-3.0	-5.4	-6.4	-6.8	-6.6
No. of rental account ('000, end of Q)	3,936	3,966	4,029	4,145	4,234	4,321	4,377	4,450	4,480	4,518	4,551	4,607
Rental account growth (QoQ)	37.1	30.7	62.3	116.3	88.9	87.2	55.4	73.4	30.0	37.6	33.7	56.2
Rental ARPU (Won)	22,002	22,056	22,105	22,187	22,218	22,586	22,845	22,993	23,164	23,319	23,325	23,357
No. of membership account ('000, end of Q)	864	897	904	938	967	1,011	1,034	1,002	1,004	1,082	1,118	1,133
Membership account growth (QoQ)	25.8	33.9	6.7	33.5	29.3	44.5	23.0	(32.4)	1.6	78.5	36.3	14.7
Membership ARPU (KRW)	13,953	13,871	13,870	13,759	13,686	13,457	13,347	13,348	12,948	12,594	12,446	12,467
Cancellation rate (%)	3.5	3.2	2.9	3.1	3.1	3.0	2.9	3.2	3.0	3.0	3.0	3.0
Sales	365	365	372	399	400	436	430	444	442	446	458	460
Chg. (%YoY)	7.0	6.2	4.8	7.4	9.4	19.3	15.6	11.3	10.6	2.4	6.5	3.6
Environmental appliance	334	335	339	354	359	378	382	386	389	401	403	402
Chg. (%YoY)					7.5	13.0	12.7	9.0	8.3	5.9	5.5	4.3
Rental	307	310	315	322	327	340	347	354	356	360	364	370
Chg. (%YoY)	4.0	3.5	4.5	7.1	6.5	9.5	10.2	9.7	8.9	6.1	5.1	4.5
Rental	272	274	277	284	288	300	306	313	317	321	323	327
Chg. (%YoY)	4.7	2.8	3.7	6.8	6.0	9.5	10.3	10.0	10.1	7.1	5.7	4.6
Membership	36	37	37	38	39	40	41	41	39	39	41	42
Chg. (%YoY)	-0.8	9.2	11.1	9.2	9.8	9.0	9.3	7.3	-0.4	-1.3	0.3	3.6
Lump sum payment	27	25	25	31	32	39	36	32	33	40	39	32
Chg. (%YoY)	117.3	85.9	-3.5	12.5	19.1	56.8	45.8	1.6	2.7	4.4	9.5	1.6
Cosmetics			2	22	17	18	18	15	17	16	17	17
Chg. (%YoY)			NA	NA	NA	NA	878.4	-29.1	-3.3	-8.8	-1.8	9.7
Exports	17	17	15	19	18	23	25	32	30	21	28	31
Chg. (%YoY)	-9.4	67.0	29.7	32.9	5.8	33.1	60.1	66.5	63.9	-8.0	14.2	-5.6
Others	14	13	16	4	5	17	6	11	7	8	9	11
Chg. (%YoY)	-2.9	-36.0	-5.7	-85.4	-63.4	26.5	-64.6	166.8	29.1	-50.4	65.9	-1.2
COGS	124	119	124	124	125	141	135	150	145	142	152	166
COGS-to-sales (%)	33.8	32.7	33.2	31.1	31.4	32.4	31.3	33.9	32.9	31.8	33.1	36.2
Rental COGS	86	86	86	90	95	95	96	100	101	102	104	109
% of sales (%)	28.0	27.7	27.5	27.9	29.0	27.9	27.6	28.3	28.5	28.2	28.7	29.5
Rental	75	74	75	78	83	82	83	88	89	89	91	95
% of sales (%)	27.6	27.1	27.0	27.5	28.7	27.4	27.2	28.0	28.1	27.7	28.3	29.2
Membership	11	12	12	12	12	13	12	13	12	13	13	13
% of sales (%)	31.2	31.4	31.2	30.6	31.9	31.7	30.4	30.8	31.7	32.3	31.6	31.8
Lump sum payment COGS	8	9	9	11	10	13	14	17	13	15	16	23
% of sales (%)	28.8	36.8	38.0	35.0	32.0	34.6	38.1	52.0	39.5	37.1	39.9	71.5
Cosmetics COGS			0	3	3	3	3	3	3	3	3	3
% of sales (%)			11.1	12.0	16.7	19.0	17.6	18.3	16.1	15.9	17.3	17.9
Exports COGS	14	13	11	15	15	18	20	25	24	16	23	26
% of sales (%)	78.6	77.3	73.2	77.3	80.3	77.7	80.0	78.0	78.7	75.0	81.5	83.6
Others COGS	10	11	11	6	3	12	3	6	5	7	6	6
% of sales (%)	67.4	81.6	71.5	147.8	50.3	71.7	49.5	52.6	70.5	85.6	61.9	53.3
Gross profit	242	246	249	275	274	295	295	294	297	304	306	294
Gross margin	66.2	67.3	66.8	68.9	68.6	67.6	68.7	66.1	67.1	68.2	66.9	63.8

Source: Korea Investment securities & Investment

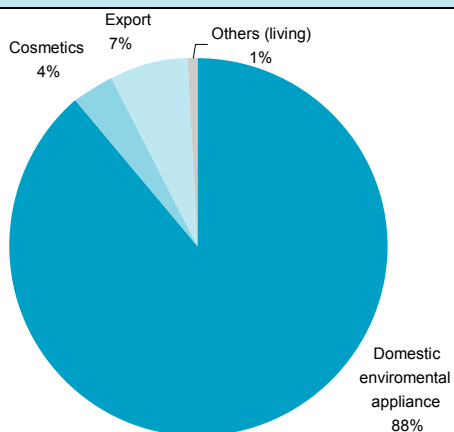
Table 2. Lift earnings forecast for 2013-2014

(Wbn,%)

	Revised		Previous		Change(%)	
	13F	14F	13F	14F	13F	14F
Sales	1,914.0	2,028.7	2,001.4	2,154.5	(4.4)	(5.8)
OP	294.8	324.7	285.2	307.0	3.4	5.8
EBT	316.2	313.4	278.1	302.4	13.7	3.6
NP	239.7	237.5	216.3	234.9	10.8	1.1

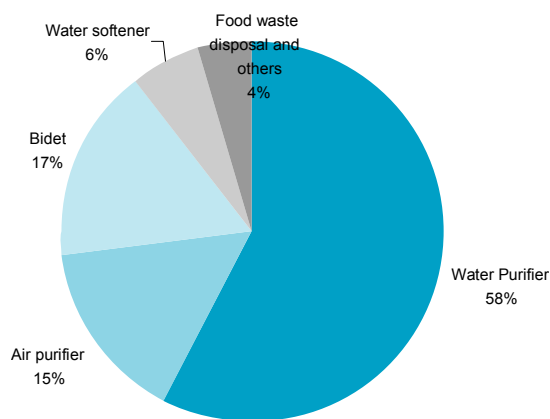
Source: Korea Investment securities & Investment

Figure 1. Coway sales breakdown in 2012



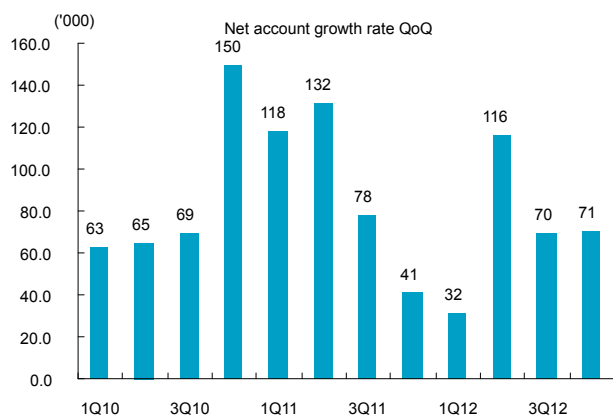
Source: Korea Investment securities & Investment, Coway

Figure 2. Water purifier is main among environmental appliances



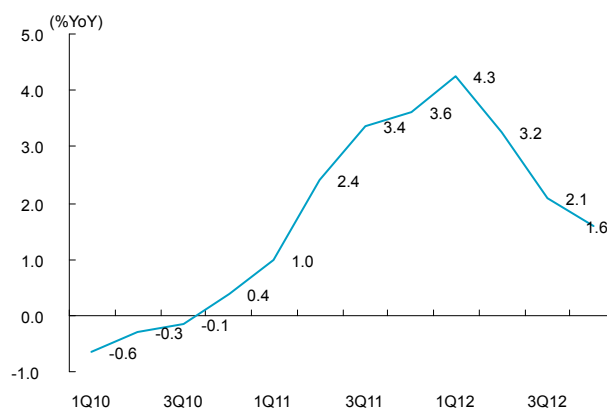
Source: Korea Investment securities & Investment, Coway

Figure 3. Robust growth of subscriber net addition, weaker than 2011 slightly



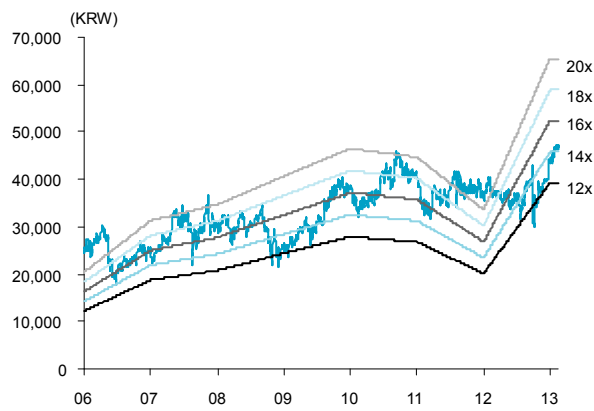
Source: Korea Investment securities & Investment, Coway

Figure 4. Still growing ARPU



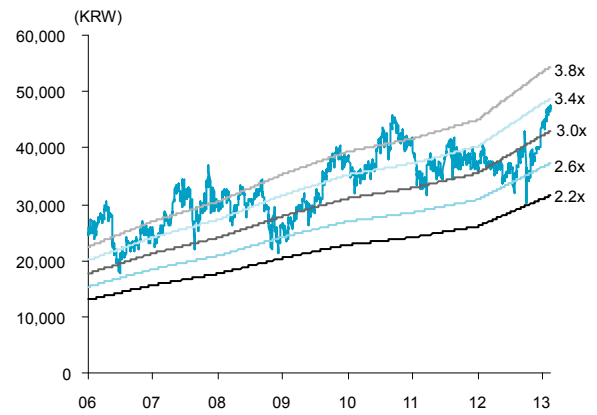
Source: Korea Investment securities & Investment, Coway

Figure 5. Coway PE band chart



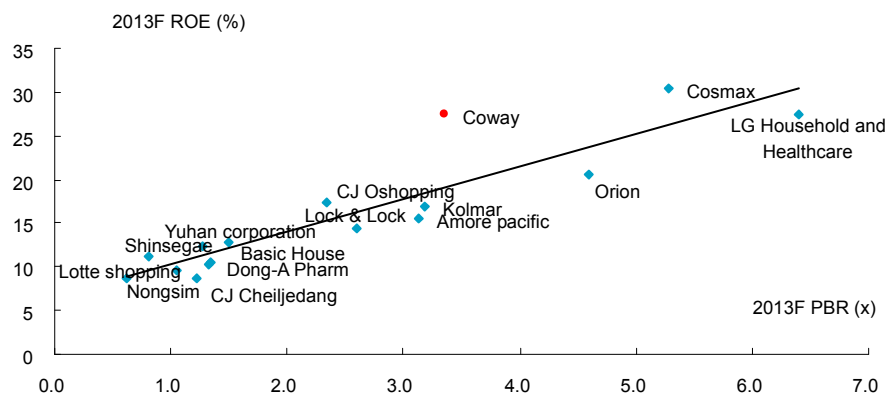
Source: Korea Investment securities & Investment, Coway

Figure 6. Coway PB band chart



Source: Korea Investment securities & Investment, Coway

Figure 7. PBR/ROE comparison to consumer peers



Source: Korea Investment securities & Investment

Balance sheet

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Current assets	441	511	575	558	636
Cash & cash equivalent	56	65	90	57	101
Accounts & other receivables	222	257	271	288	305
Inventory	73	73	77	82	87
Non-current assets	917	1,065	1,107	992	1,029
Investment assets	241	285	301	159	169
Tangible assets	442	535	546	558	570
Intangible assets	156	156	165	175	185
Total assets	1,358	1,576	1,681	1,549	1,665
Current liabilities	385	534	518	369	384
Accounts & other payables	197	187	198	210	222
ST debt & bond	74	165	165	0	0
Current portion of LT debt	30	110	110	110	110
Non-current liabilities	247	294	296	248	220
Debentures	50	177	177	127	97
LT debt & financial liabilities	170	90	91	91	91
Total liabilities	631	828	813	617	604
Paid-in capital	41	41	41	41	41
Capital surplus	131	131	131	131	131
Capital adjustments	(27)	(99)	(99)	(99)	(99)
Retained earnings	583	678	797	862	991
Shareholders' equity	727	748	868	932	1,062
Adj. shareholders' equity	765	738	805	979	1,127

Cash flow

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
C/F from operating	331	318	314	318	386
Net profit	183	177	120	240	238
Depreciation	132	145	162	166	169
Amortization	7	8	8	8	9
Net incr. in W/C	(86)	(112)	24	(96)	(31)
Others	95	100	0	0	1
C/F from investing	(300)	(344)	(211)	(59)	(215)
CAPEX	(223)	(299)	(174)	(177)	(181)
Decr. in fixed assets	11	9	0	0	0
Incr. in investment	(70)	(42)	(16)	142	(10)
Net incr. in intangible assets	(15)	(7)	(17)	(18)	(19)
Others	(3)	(5)	(4)	(6)	(5)
C/F from financing	(38)	36	(78)	(293)	(127)
Incr. in equity	2	0	0	0	0
Incr. in debts	55	213	0	(215)	(30)
Dividends	(77)	(80)	(78)	(78)	(97)
Others	(18)	(97)	0	0	0
C/F from others	(1)	(0)	0	0	0
Increase in cash	(7)	8	25	(33)	44

Note: 1. Based on K-IFRS (non-consolidated)
2. EPS and BPS are calculated using adjusted net profit and shareholders' equity that includes equity-method gains/losses
3. Different from past OP due to accounting method change. It is caused by KIS assumption for other non-operating profit and cost. It will be readjusted.

Income statement

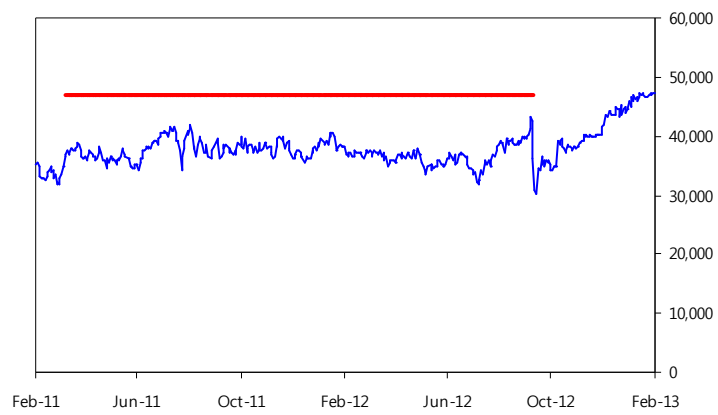
FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Sales	1,502	1,710	1,807	1,914	2,029
COGS	491	552	605	624	657
Gross profit	1,011	1,158	1,201	1,290	1,371
SG&A expense	704	869	891	933	980
Operating profit	254	242	221	295	325
Financial income	6	2	3	3	3
Interest income	2	2	2	2	2
Financial expense	18	26	66	20	14
Interest expense	18	25	26	20	14
Other non-operating profit	(52)	(40)	0	38	0
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	243	225	158	316	313
Income taxes	60	48	38	77	76
Net profit	183	177	120	240	238
Other comprehensive profit	(3)	(4)	0	0	0
Total comprehensive profit	180	173	120	240	238
EBITDA	392	395	391	469	503
Adj. net profit	177	167	125	245	243

Key financial data

FY-ending Dec.	2010A	2011A	2012F	2013F	2014F
per share data (KRW)					
EPS	2,327	2,235	1,682	3,278	3,250
BPS	10,358	10,962	11,837	14,084	16,000
DPS	1,050	1,050	0	2,350	1,450
Growth (%)					
Sales growth	6.4	13.9	5.7	5.9	6.0
OP growth	24.1	(4.4)	(8.9)	33.4	10.1
NP growth	15.5	(5.6)	(25.3)	96.0	(0.9)
EPS growth	14.4	(3.9)	(24.8)	94.9	(0.9)
EBITDA growth	11.2	0.8	(1.0)	19.9	7.2
Profitability (%)					
OP margin	16.9	14.2	12.2	15.4	16.0
NP margin	11.8	9.8	6.9	12.8	12.0
EBITDA margin	26.1	23.1	21.6	24.5	24.8
ROA	13.9	12.1	7.4	14.8	14.8
ROE	24.5	22.2	16.2	27.4	23.0
Dividend yield	2.6	2.9	0.0	5.0	3.1
Stability					
Net debt (W bn)	264	468	443	261	186
Debt/equity ratio (%)	44.6	72.4	62.5	35.2	28.1
Valuation (X)					
PER	17.3	16.4	25.9	14.5	14.6
PBR	3.9	3.3	3.7	3.4	3.0
PSR	2.1	1.7	1.9	1.9	1.8
EV/EBITDA	8.5	8.1	9.4	8.1	7.4

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Coway (021240)	03-25-11	BUY	W47,000
	09-28-12	Hold	-
	02-18-13	BUY	W56,000



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- 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
- Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

■ **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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Prepared by: Eun-cha Na

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