

April 8, 2013 Company Analysis



Coway (021240)

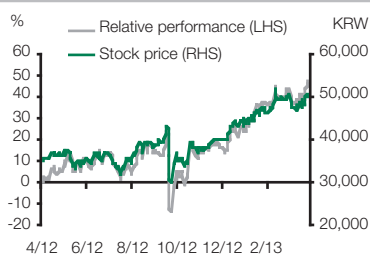
BUY (maintain)



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Current price (Apr 5)	KRW50,000		
Fair value	KRW65,000		
Preference level within sector	★★★		
Reuters code	021240.KS		
Bloomberg code	021240 KS		
Industry/Sector	Other Consumer Services		
Rating	Overweight		
Market cap	USD3.4bn		
Ordinary shares issued	77,124,796shrs		
Free float	62.7%		
KOSPI	1927.23		
KOSDAQ	547.51		
Avg T/O Vol (60d)	199,603shrs		
Avg T/O Val (60d)	USD8.4mn		
Foreign ownership	51.4%		
3yr CAGR of adj EPS (13~15)	31.3%		
Market's 3yr CAGR of adj. EPS	14.8%		
52wk high/low	KRW51,700 / KRW30,150		
Beta (12M, daily return)	0.2		
Major shareholders	Coway Holdings, Inc. 30.9%		
Price performance	1M	3M	6M
Absolute	1.0%	11.9%	45.8%
Relative	5.7%	16.8%	50.9%



Service Fee Increases and Re-emerging Valuation Merits

- Service fee increases to contribute in full swing from 2014
- Service fee increases to lead to earnings momentum
- 1Q13 OP to show stable 8%YoY growth

Service fee increases to contribute in full swing from 2014

Coway adjusted its rental/membership service fees for new customers on Apr 1. Considering the company's earnings model, such an adjustment will have a limited impact on 2013 OP, but pushes up our 2014 OP estimate by 5% and our 2015 OP estimate by 9%, which is encouraging.

The stock has undergone corrections over the past six months after exhibiting sharp price rallies. The stock may appear expensive in terms of its 2013 PER of 17x, but its 2014 PER is only at 15x. Coway's earnings model is immune to economic fluctuations and the company is seeing earnings momentum with OP to grow at a CAGR of 18% over the next three years. As such, the stock still remains undervalued. We retain the stock as our top pick.

Service fee increases to lead to earnings momentum

The company has been making efforts to enhance profitability by adjusting prices, such as rental fees, since 2006. Rental fees were hiked 6% in 2006 and membership services fees 20%. This was done in order to target new customers and to reflect inflation.

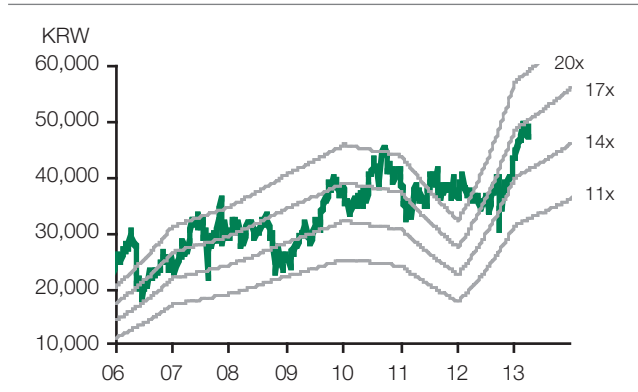
FY-end	12/11A	12/12A	12/13F	12/14F	12/15F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
OR (KRWbn)	1,824.4	1,992.8	2,106.0	2,237.0	2,392.0
OP (KRWbn)	233.2	226.1	296.2	339.8	375.6
NP (KRWbn)	167.1	94.0	249.8	249.5	276.6
Parent NP (KRWbn)	167.1	94.0	249.8	249.5	276.6
EPS (KRW)	2,192	1,247	3,299	3,294	3,652
Adj. EPS (KRW)	2,192	1,615	2,854	3,294	3,652
PER* (x)	19.5 - 14.2	27.5 - 17.7	17.5	15.2	13.7
PBR (x)	3.7	4.2	4.0	3.4	2.9
EV/EBITDA (x)	7.3	9.3	8.0	7.0	6.5
Div. Yield (%)	2.9	0.0	4.2	2.1	2.1
ROE (%)	22.6	12.3	26.1	24.0	22.6
ROIC (%)	19.7	17.3	19.5	24.4	25.5

Note: IFRS-C = Consolidated financial statements; IFRS-P = Individual financial statements

Source: Company data, Hyundai Securities

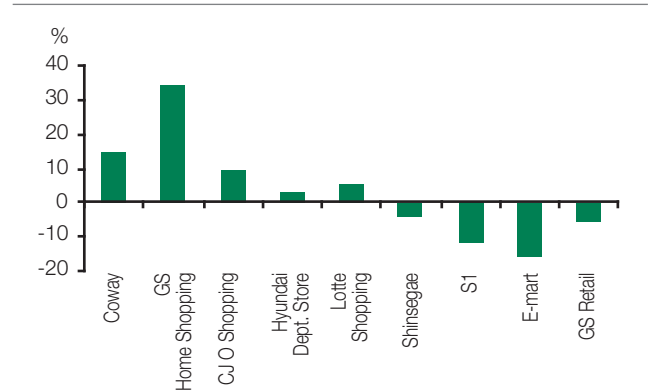
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Fig 1: Revaluation to continue (PER band)



Source: Quantwise, Hyundai Securities

Fig 2: Coway's earnings yield strong starting in 2013 compared to market



Source: Quantwise, Hyundai Securities

Service fee increases to lead to earnings momentum (continued)

In 2009, the mandatory usage period for rentals was adjusted to two years from one year. In addition, through a price system, which lowered initial fee burdens etc., there was a 6% rental fee hike effect. Fee adjustments were expected in 2012 as well, but were delayed due to the Group's situation.

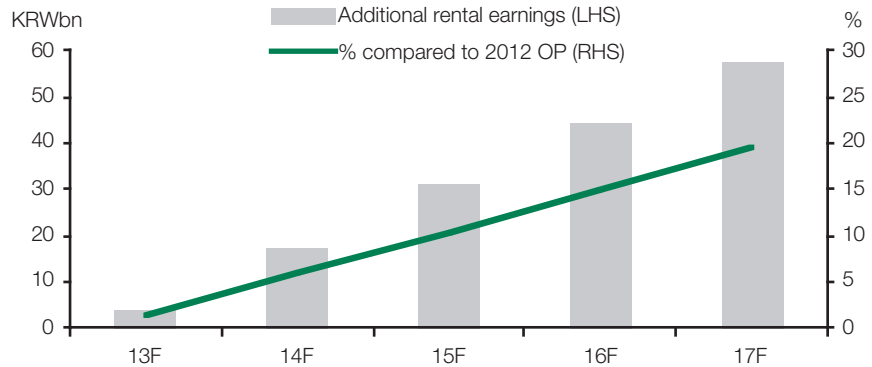
In 2013, fees were increased for the first time in seven years. The hike rate differed slightly from the assumed 6% published in our in-depth reports on Apr 3 and Apr 4, due to the company's product sale structure. In general, the increase rates are 5%-6% for rentals, 5% for re-rentals, and 7% for membership services. The rise in re-rental fees for existing customers is lower than for new customers.

With annual unit sales at 1.2mn, of which re-rentals are assumed to contribute 40%, additional OR of about KRW6bn is expected in 2013, KRW25bn in 2014, and KRW44bn in 2015,

Additional income from fee increases is estimated to reach KRW4bn in 2013, KRW17bn in 2014, and KRW31bn in 2015. Fee hikes are expected to contribute 1% to total OP in 2013, but the percentage is expected to expand to 5% in 2014 and 9% in 2015.

Concerns may arise over the possible adverse effects from the fee increases, such as subscriber migration (higher cancellations, etc.). However, chances are slim that such worries will come to materialize, since the fees will be increased for new subscribers only, and Coway's fee increases tend to trigger similar moves by second-tier companies as well.

Fig 3: Service fee increases to have enormous effect



Source: Company data, Hyundai Securities

Fig 4: 2014 earnings estimates adjusted upward about 6%

(KRWbn)	2012	Revised			Previous			Change (%)		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
IFRS parent										
OR	1,806.8	1,912.0	2,042.4	2,195.1	1,906.0	2,017.0	2,150.0	3.1	1.3	2.1
OP	227.8	296.2	339.8	375.6	292.0	322.0	344.0	1.4	5.5	9.2
NP	119.8	249.8	249.5	276.6	246.6	236.0	251.0	1.3	5.7	10.2
Adj. EPS (KRW)	1,955	2,854	3,294	3,652	2,812	3,118	3,316	1.5	5.6	10.1

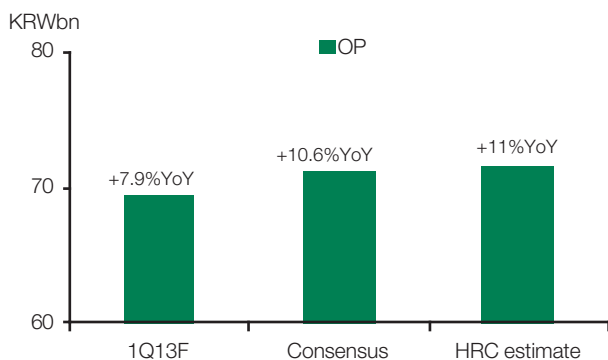
Source: Hyundai Securities

1Q13 OP to show stable 8%YoY growth

1Q13 results (stand-alone basis) are scheduled to be released in early May. The results will feature changes in operating strategies since the takeover by MBK Partners. Due to profitability-oriented operations, top-line growth is projected to reach only 5%YoY, but OP growth is estimated to post at 8%YoY and the OP margin at 15% (versus 2013 guidance of 15.2%).

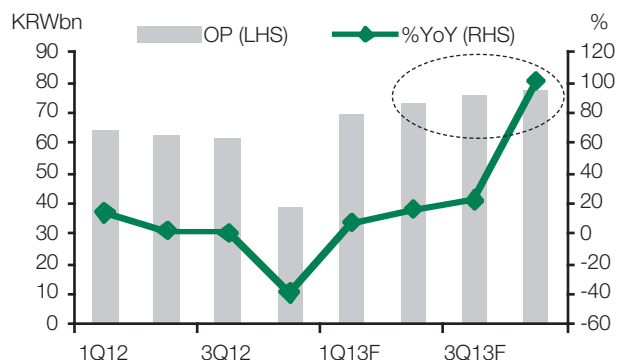
The reinforced profitability of wellness home appliances and reduced losses from domestic cosmetics should lead to overall earnings improvement. However, the extent of earnings improvement will unlikely be as high as expected due to advance expenses. Nonetheless, the 2013 OP margin is expected to match our estimate of 15.3% (15.5% after fee increases). Cost savings and profitability-oriented operations should produce visible effects from 2H13.

Fig 5: 1Q13 earnings to show stable recovery



Source: FnGuide, Hyundai Securities

Fig 6: Earnings recovery to accelerate after 2Q13



Source: Hyundai Securities

Profit & Loss					
(KRWbn)	12/11A	12/12A	12/13F	12/14F	12/15F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	1,824.4	1,992.8	2,106.0	2,237.0	2,392.0
Cost of sales	580.8	678.3	666.0	710.0	777.6
Gross profit	1,243.5	1,314.5	1,440.0	1,527.0	1,614.4
SG&A expenses	955.0	1,088.4	1,091.8	1,127.2	1,190.8
Other operating income	(55.3)	0.0	(52.0)	(60.0)	(48.0)
Operating profit	233.2	226.1	296.2	339.8	375.6
EBITDA	448.0	409.8	510.7	564.8	589.6
Non-operating accounts	(15.7)	(80.4)	33.3	(10.7)	(10.7)
Net financing income	(24.3)	(28.0)	(21.7)	(20.7)	(20.7)
Profit on equity method	3.4	5.4	10.0	10.0	10.0
Net other non-operating income	5.3	(57.8)	45.0	0.0	0.0
Profit before tax	217.5	145.8	329.5	329.1	364.9
Income tax expense	50.5	51.7	79.7	79.6	88.3
Net profit	167.1	94.0	249.8	249.5	276.6
Profit attributable to owners of parent	167.1	94.0	249.8	249.5	276.6
Total comprehensive income	161.2	98.9	249.8	249.5	276.6
TCI, attributable to owners of parent	161.2	98.9	249.8	249.5	276.6
Net exceptional gains	0.0	(27.8)	33.8	0.0	0.0
Adj. net profit	167.1	121.8	216.0	249.5	276.6

Cash Flow					
(KRWbn)	12/11A	12/12A	12/13F	12/14F	12/15F
Net profit	167.1	94.0	249.8	249.5	276.6
Depreciation & amortization	159.5	183.6	162.5	165.0	166.0
Other non-cash adjustments	151.8	236.6	86.6	69.6	78.3
Investments in working capital	(120.8)	(23.9)	(28.4)	(30.5)	(2.0)
Other operating cash flow	(43.1)	(36.0)	(105.1)	(79.6)	(88.3)
Cash flow from operating activities	314.5	454.3	365.3	374.0	430.6
Capital expenditure	(302.8)	(310.3)	(290.0)	(295.8)	(301.7)
Investments in intangibles	(6.8)	(7.7)	(15.0)	(15.0)	(15.0)
Changes in current financial assets	(0.5)	(2.4)	(3.6)	(3.6)	(3.6)
Changes in investment assets	(7.8)	(1.6)	0.0	0.0	0.0
Other investment cash flow	(6.4)	1.6	183.3	0.0	0.0
Cash flow from investing activities	(324.2)	(320.4)	(125.3)	(314.4)	(320.3)
Proceeds from (repayments of) debt	208.7	19.9	55.0	0.0	0.0
Changes in equity	(73.5)	12.2	0.0	0.0	0.0
Dividends paid	(79.9)	(77.8)	0.0	(79.5)	(79.5)
Other financing cash flow	(24.8)	(29.9)	(112.2)	59.3	133.3
Cash flow from financing activities	30.5	(75.6)	(57.2)	(20.2)	53.8
Other cash flow	2.8	(4.1)	0.0	0.0	0.0
Increase/decrease in cash	23.6	54.2	182.8	39.4	164.1
Cash and cash equivalents at FYB	74.6	98.2	152.4	335.2	374.6
Cash and cash equivalents at FYE	98.2	152.4	335.2	374.6	538.7
Gross operating cash flow	351.7	356.0	361.6	422.6	450.7
Free cash flow	(74.9)	7.4	31.2	81.2	132.0
Net cash flow	(181.8)	46.1	227.2	89.4	145.1
Net cash (net debt)	(445.8)	(433.0)	(205.8)	(116.4)	28.7

Operating Statistics & Ratios					
(%)	12/11A	12/12A	12/13F	12/14F	12/15F
OR growth	NA	9.2	NA	6.2	6.9
OP growth	NA	(3.0)	NA	14.7	10.5
EBITDA growth	NA	(8.5)	NA	10.6	4.4
NP growth of parent	(5.6)	(43.7)	165.6	(0.1)	10.9
Adj. NP growth	(5.6)	(27.1)	77.4	15.5	10.9
OP margin	12.8	11.3	14.1	15.2	15.7
EBITDA margin	24.6	20.6	24.2	25.2	24.6
NP margin	9.2	4.7	11.9	11.2	11.6
Adj. NP margin	9.2	6.1	10.3	11.2	11.6

Note: IFRS-C = Consolidated financial statements; IFRS-P = Individual financial statements

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) × (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

Statement of financial position					
(KRWbn)	12/11A	12/12A	12/13F	12/14F	12/15F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Cash and cash equivalents	98.2	152.4	335.2	374.6	538.7
Current financial assets	2.2	3.1	9.0	9.0	9.0
Trade receivables	205.3	233.0	210.0	240.0	250.0
Inventories	103.7	71.7	42.0	45.0	47.0
Other current assets	163.2	318.9	282.0	300.0	315.0
Current assets	572.6	779.2	878.2	968.6	1,159.7
Investment assets	229.0	78.0	150.0	150.0	150.0
Property, plant and equipment	568.9	630.4	634.8	674.8	724.8
Intangible assets	183.2	183.7	160.0	160.0	160.0
Deferred tax assets	0.7	0.5	0.0	0.0	0.0
Other non-current assets	70.4	83.4	63.4	63.4	63.4
Non-current assets	1,052.1	975.9	1,008.3	1,048.3	1,098.3
Total assets	1,624.7	1,755.1	1,886.5	2,016.9	2,257.9
Trade payables	51.9	46.3	45.5	50.0	55.0
Short-term financial liabilities	278.8	440.6	400.0	350.0	300.0
Current provisions	6.9	6.3	4.4	4.4	4.4
Other current liabilities	240.7	266.0	314.0	330.0	350.0
Current liabilities	578.3	759.2	763.9	734.4	709.4
Non-current financial liabilities	267.3	147.9	150.0	150.0	219.0
Non-current provisions	0.7	0.6	0.1	0.0	0.0
Provisions for employee benefits	14.6	12.8	10.0	0.0	0.0
Deferred tax liabilities	8.6	25.9	0.0	0.0	0.0
Other non-current liabilities	17.2	23.6	7.2	7.2	7.2
Non-current liabilities	308.5	210.9	167.3	157.2	226.2
Total liabilities	886.8	970.0	931.2	891.6	935.6
Issued capital	40.7	40.7	40.7	40.7	40.7
Share premium	126.3	126.0	126.0	126.0	126.0
Other equity interest	(98.8)	(84.6)	(84.6)	(84.6)	(84.6)
Accumulated other comprehensive income	(5.9)	2.1	2.1	2.1	2.1
Retained earnings	675.7	700.9	871.1	1,041.0	1,238.1
Equity attributable to owners of parent	737.9	785.1	955.3	1,125.3	1,322.4
Non-controlling interests	0.0	0.0	0.0	0.0	0.0
Total equity	737.9	785.1	955.3	1,125.3	1,322.4
Total Liab. and equity	1,624.7	1,755.1	1,886.5	2,016.9	2,257.9

Per-share Performance					
(KRW)	12/11A	12/12A	12/13F	12/14F	12/15F
EPS	2,192	1,247	3,299	3,294	3,652
Adj. EPS	2,192	1,615	2,854	3,294	3,652
BPS	9,813	10,376	12,613	14,857	17,459
SPS	23,943	26,420	27,819	29,535	31,582
GCFPS	4,615	4,720	4,777	5,579	5,951
DPS	1,050	0	2,100	1,050	1,050
3yr CAGR of adj. EPS	7.5	14.5	31.3	NA	NA

Shareholder Value & Financial Structure					
(%)	12/11A	12/12A	12/13F	12/14F	12/15F
ROE	22.6	12.3	26.1	24.0	22.6
ROA	11.5	6.9	14.1	13.6	13.7
ROIC	19.7	17.3	19.5	24.4	25.5
WACC	9.0	4.1	4.4	4.3	4.5
ROIC/WACC (x)	2.2	4.2	4.4	5.6	5.7
Economic profit (KRWbn)	118.1	132.1	154.1	213.2	235.9
Total liab./equity	120.2	123.6	97.5	79.2	70.7
Net debt/equity	60.4	55.2	21.5	10.3	Net cash
Interest coverage (x)	17.0	13.5	23.2	26.9	28.1

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Company: Strong BUY (+30% or more), BUY (+10 - +30%), Marketperform (-10 - +10%), Underperform (-10% or more)
Strong BUY = 4, BUY = 3, Marketperform = 2, Underperform = 1, Blackout/Universe Exclusion = 0 (Share price —, Fair value ▲, Rating —)
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