

Coway (021240)

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Rating **BUY**
maintain

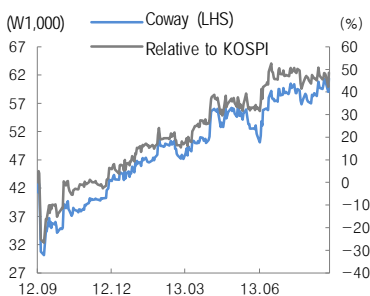
6M TP (₩) **74,000**
maintain

CP (₩)
(13.09.17) **61,400**

Other services

KOSPI	2005.58
Market cap (₩bn)	4,735
Market cap portion (%)	0.40
Paid-in capital (common; ₩bn)	41
52w high/low (₩)	61,400 / 30,150
120d avg. trading volume (₩bn)	9.8
Foreign ownership (%)	53.03
Major shareholders	Coway Holdings+16: 31.05% Lazard Asset Mgmt. LLC+32: 11.71%

(%)	1M	3M	6M	12M
Abs. return	6.4	16.7	28.6	55.4
Rel. return	1.9	9.6	27.4	55.2



Nice 3Q13 earnings are on the way

3Q13 earnings will satisfy

- Net rental orders for July-August were flat or down slightly yoy despite customer dissatisfaction over April's price hike and the absence of new products. Meanwhile, the rental cancellation rate held at 1.0%. Rental sales growth is forecast at 4-5% in 3Q13, similar to the 2Q13 level, amid an increase in rental customer accounts despite April's price hike.
- Membership accounts look little changed after a drop in free accounts related to lump-sum payment sales. Revenue is forecast to grow 4% yoy on a higher average selling price and a drop in unprofitable accounts. Lump-sum payment sales maintained double-digit growth with help from robust dehumidifier sales in July-August.
- Exports are forecast to increase 40% on strong ODM sales of water purifiers to Philips. Water treatment equipment sales look flat yoy. Cosmetics sales are projected to show a moderate qoq decrease and a 10% yoy increase.
- On a non-consolidated basis, 3Q13 sales and OP are forecast to expand 7.3% and 23.7%, respectively, to ₩491.3bn and ₩77.8bn from a year ago. OP and NP will be about the same on a consolidated basis and on a non-consolidated basis.

Strong earnings momentum is likely in 2H13; earnings growth will continue into 2014

- Coway's miniature water purifier No. 2 model is set for release in late September or early October. Customer acceptance of April's price hike will grow toward the end of the year. Net rental orders are forecast to rise back above 300,000 units in 4Q13.
- Earnings growth will likely continue to outpace sales growth in 2H13 thanks to cost reductions and SG&A expense controls. For 4Q13, OP is forecast to jump 116% yoy against the low comparison base of 4Q12 when the company incurred large one-off costs.
- ODM exports are growing faster than expected. ODM sales of air purifiers to Philips China is forecast to surpass the company's annual target of ₩38.9bn and reach ₩60-70bn. OP margins are growing from a low single digit last year to a double-digit pace on economies of scale stemming from rapid sales expansion.
- April's price hike will not translate into a significant boost to sales and earnings in 2013 as price rise effects will gradually increase through 1H14.

BUY, 6M TP of ₩74,000

- We maintain our BUY rating and six-month target price of ₩74,000 on Coway, which is a strong defensive play.
- Earnings will continue to improve in 2H13 and 2014. Coway is expected to forge various partnerships in 2014 to capitalize on its door-to-door sales channels. Its overseas business will begin to come into focus in light of strong overseas ODM sales growth and overseas subsidiary earnings growth, especially at US and Malaysia units.
- Even after the post-sale share price rally, valuations are on the low side relative to peers with the end-2013 dividend estimated at ₩1,100 or more.

Operating results and major financial data

(Wbn, W, x, %)

	2011A	2012A	2013F	2014F	2015F
Sales	1,710	1,807	1,944	2,064	2,187
OP	242	228	303	334	378
Pretax profit	225	161	339	323	384
NP	177	120	249	245	291
NP (controlling int.)	177	120	249	245	291
EPS	2,296	1,553	3,233	3,174	3,770
PER	15.9	28.0	18.3	18.6	15.7
BPS	9,704	10,408	13,641	14,682	17,240
PBR	3.8	4.2	4.3	4.0	3.4
ROE	23.9	15.4	26.9	22.4	23.6

Note: EPS, BPS, and ROE are based on controlling interests.
Source: Coway, Daishin Securities Research Center

Tab 1. Coway quarterly and annual earnings trend and forecast

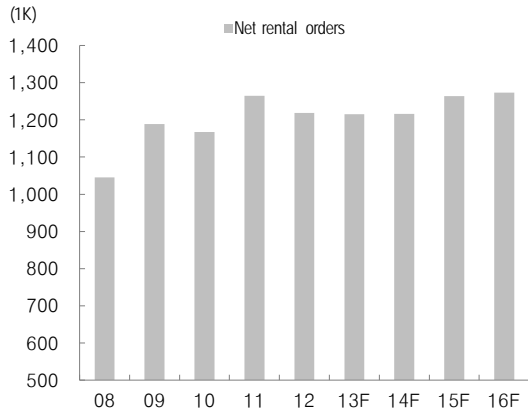
(Wbn, %)

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13F	4Q13F	2012	2013F	2014F	2015F
Rental orders ('000)	284.7	331.1	293.5	309.6	318.0	298.4	293.3	305.5	1,218.9	1,215.3	1,216.4	1,264.0
Monthly cancellation rate (%)	1.01%	1.00%	1.00%	0.99%	1.01%	0.90%	0.92%	0.95%	1.01%	0.96%	0.93%	0.92%
Rental accounts ('000)	4,480.0	4,517.6	4,551.2	4,607.4	4,657.8	4,716.8	4,765.8	4,813.4	4,607.4	4,813.4	4,972.8	5,125.1
Membership accounts	1,003.6	1,082.1	1,118.5	1,133.1	1,135.3	1,099.6	1,107.3	1,121.0	1,133.1	1,121.0	1,185.0	1,256.9
Total customer accounts	5,483.6	5,599.7	5,669.7	5,740.5	5,793.1	5,816.4	5,873.1	5,934.5	5,740.5	5,934.5	6,157.8	6,382.1
Chg in total customer accts.	31.6	116.1	70.0	70.8	52.6	23.3	56.7	61.4	288.5	193.9	223.4	224.2
Sales												
Total	442.4	446.4	458.0	460.1	465.2	496.9	491.3	490.6	1,806.8	1,944.0	2,064.2	2,186.7
Rental	316.3	318.9	323.2	327.3	327.4	331.9	338.1	342.5	1,285.7	1,340.0	1,409.0	1,469.0
Membership	38.8	39.2	41.1	42.3	42.8	42.8	42.6	43.3	161.3	171.4	180.9	196.9
Bullet payment	32.7	40.5	39.1	32.4	36.6	47.8	43.3	33.7	144.7	161.4	171.3	181.9
Others	37.8	31.5	37.4	41.2	40.5	52.3	48.2	51.8	155.5	192.8	218.4	247.5
Cosmetics	16.8	16.3	17.3	16.8	17.9	22.1	19.0	19.3	67.2	78.3	84.6	91.4
YoY (%)												
Total	10.6	2.4	6.5	3.6	5.2	11.3	7.3	6.6	5.7	7.6	6.2	5.9
Rental	9.8	6.4	5.7	4.6	3.5	4.1	4.6	4.6	6.6	4.2	5.1	4.3
Membership	(0.8)	(1.9)	0.3	3.7	10.4	9.1	3.7	2.4	0.3	6.3	5.5	8.9
Bullet payment	2.8	4.4	9.5	1.7	11.9	18.1	10.8	3.8	4.7	11.5	6.1	6.2
Others	60.9	(20.5)	23.9	(4.4)	7.3	65.9	29.0	25.6	2.5	24.0	13.3	13.3
Cosmetics	(3.3)	(8.8)	(1.7)	9.5	6.3	35.5	10.0	15.0	(1.4)	16.5	8.0	8.0
GP	296.9	304.3	306.5	293.8	310.5	329.0	327.8	326.8	1,201.4	1,294.2	1,380.7	1,470.6
OP	64.1	65.1	62.9	35.6	69.2	79.4	77.8	76.8	227.8	303.2	334.1	377.8
Pretax profit	55.6	56.4	17.7	31.7	115.0	80.7	72.7	70.5	161.5	338.9	322.9	383.6
NP	41.2	44.0	12.9	21.6	80.2	60.6	55.1	53.4	119.7	249.3	244.8	290.7
YoY (%)												
GP	8.2	3.3	3.8	0.1	4.6	8.1	7.0	11.2	3.8	7.7	6.7	6.5
OP	13.6	5.4	2.4	(44.0)	7.9	21.9	23.7	115.5	(6.4)	33.1	10.2	13.1
Pretax profit	10.3	2.5	(72.6)	(42.5)	106.7	43.1	311.0	122.1	(28.3)	109.9	(4.7)	18.8
NP	6.4	4.6	(73.7)	(54.2)	94.5	37.6	327.0	147.5	(32.4)	108.2	(1.8)	18.8
GP margin (%)	67.1	68.2	66.9	63.9	66.8	66.2	66.7	66.6	66.5	66.6	66.9	67.3
OP margin (%)	14.5	14.6	13.7	7.7	14.9	16.0	15.8	15.7	12.6	15.6	16.2	17.3
Pretax margin (%)	12.6	12.6	3.9	6.9	24.7	16.2	14.8	14.4	8.9	17.4	15.6	17.5
NP margin (%)	9.3	9.9	2.8	4.7	17.2	12.2	11.2	10.9	6.6	12.8	11.9	13.3

Source: Coway, Daishin Securities Research Center

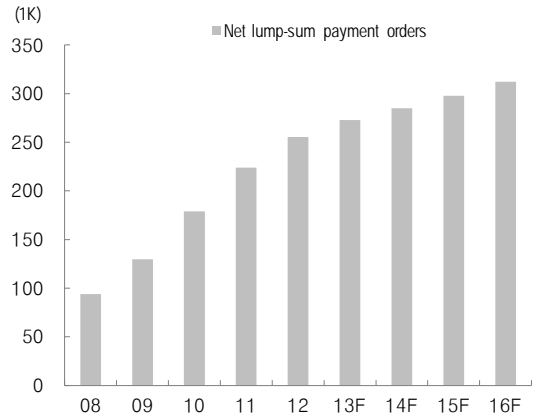
Note: 1Q12-3Q12 OP are revised figures adjusted for accounting changes that were made later in 4Q12.

Fig 1. Yearly net rental order trend and forecast



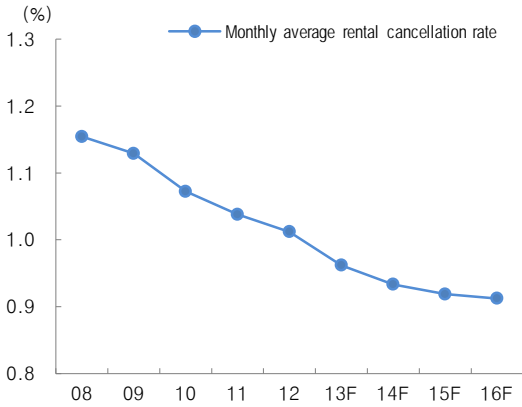
Source: Coway, Daishin Securities Research Center

Fig 2. Yearly lump-sum payment order trend and forecast



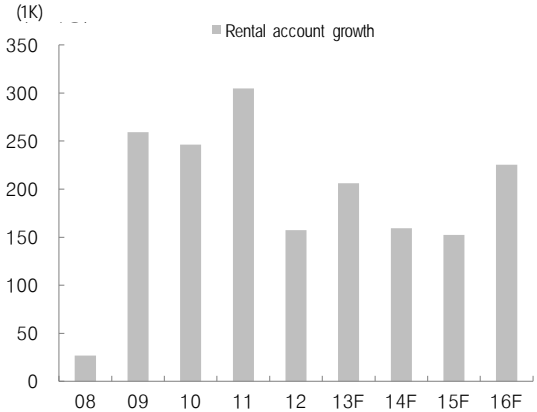
Source: Coway, Daishin Securities Research Center

Fig 3. Monthly average rental cancellation trend and forecast



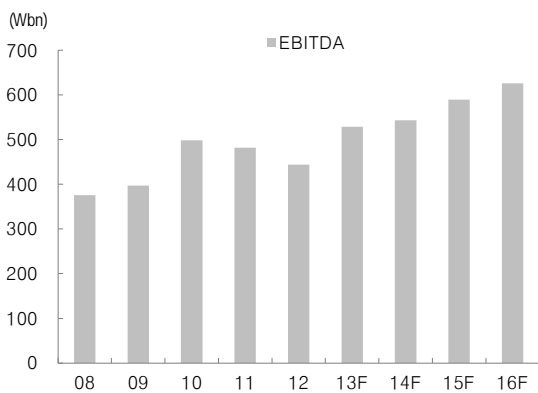
Source: Coway, Daishin Securities Research Center

Fig 4. Yearly rental account growth trend and forecast



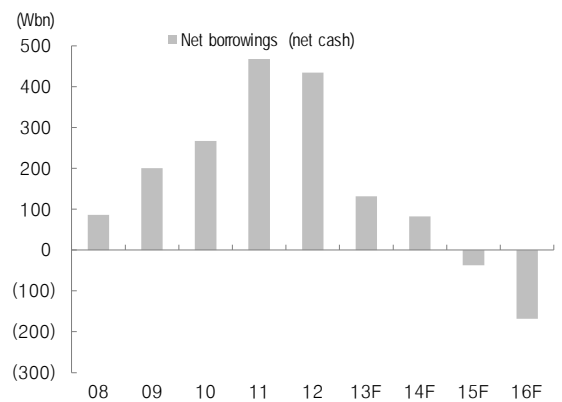
Source: Coway, Daishin Securities Research Center

Fig 5. EBITDA trend and forecast



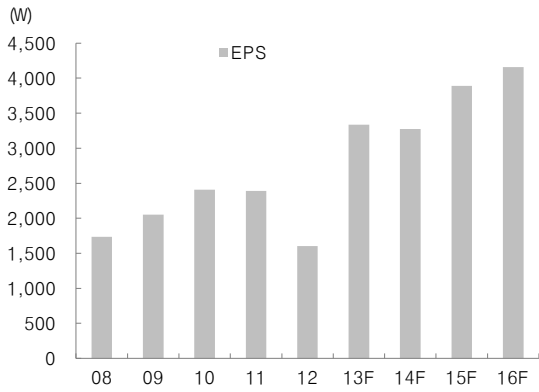
Note: EBITDA = OP + Depreciation cost of tangible & intangible assets + Loss on abandonment of rental assets

Fig 6. Net debt trend and forecast



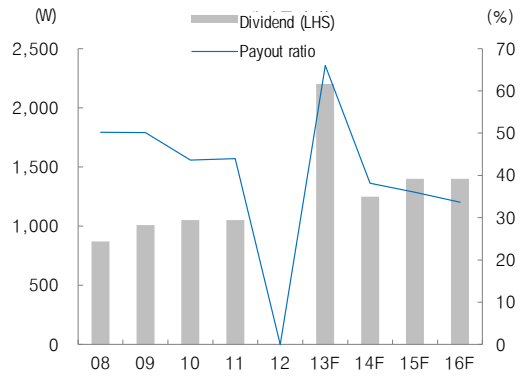
Source: Coway, Daishin Securities Research Center

Fig 7. EPS trend and forecast (excl. treasury shares)



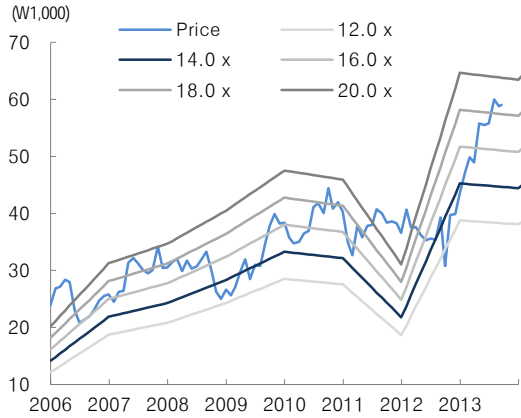
Source: Coway, Daishin Securities Research Center

Fig 8. DPS and payout ratio trend and forecast



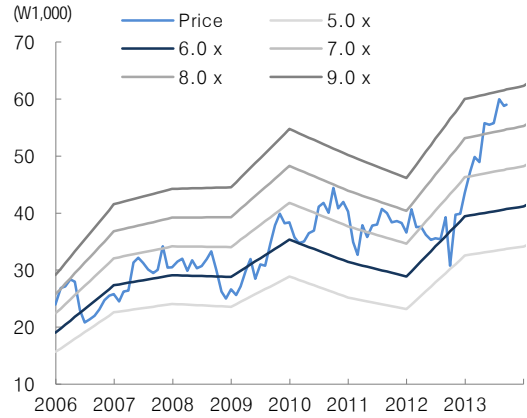
Source: Coway, Daishin Securities Research Center

Fig 9. 12M Fwd P/E band



Source: WISEfn, Daishin Securities Research Center

Fig 10. 12M Fwd EV/EBITDA band



Source: WISEfn, Daishin Securities Research Center

Financial statements

Income statement						Balance sheet					
	(Wbn)						(Wbn)				
	2011A	2012A	2013F	2014F	2015F		2011A	2012A	2013F	2014F	2015F
Sales	1,710	1,807	1,944	2,064	2,187	Current assets	511	691	859	741	880
Cost of goods sold	552	605	650	684	716	Cash & cash equiv.	65	119	282	189	305
Gross profit	1,158	1,201	1,294	1,381	1,471	Trade & other receive.	257	292	313	283	296
SG&A expenses	869	974	991	1,047	1,093	Inventories	73	41	49	48	51
OP	242	228	303	334	378	Other current assets	117	239	215	222	228
OP margin	14.2	12.6	15.6	16.2	17.3	Long-term assets	1,065	1,010	958	1,021	1,083
EBITDA	482	444	529	543	589	Tangible assets	535	594	662	719	773
Non-OP	-17	-66	-9	-11	-8	Investments in affiliates	237	102	-31	-31	-31
Income from affiliates	0	-3	0	0	0	Other long-term assets	293	314	326	332	341
Financial revenue	2	4	2	0	0	Total assets	1,576	1,702	1,817	1,762	1,963
FX related gains	9	11	12	0	0	Current liabilities	534	720	660	510	593
Financial expense	-26	-62	-19	-16	-13	Payables & other liab.	187	205	202	204	206
FX related losses	0	0	0	0	0	Borrowings	165	296	196	186	183
Others	6	-5	8	5	5	Current portion of LT debts	110	110	147	0	80
Income before taxes	225	161	339	323	384	Other current liabilities	72	109	116	120	125
Income tax expense	-48	-42	-90	-78	-93	Long-term liabilities	294	179	104	120	41
Income from cont. op.	177	120	249	245	291	Borrowings	267	148	71	86	6
Income from discount. op.	0	0	0	0	0	Convertible securities	0	0	0	0	0
NP	177	120	249	245	291	Other long-term liab.	27	31	33	34	35
NP margin	10.4	6.6	12.8	11.9	13.3	Total liabilities	828	899	765	629	634
NP for non-contr. interest	0	0	0	0	0	Controlling interest	748	803	1,052	1,132	1,330
NP for contr. interest	177	120	249	245	291	Capital stock	41	41	41	41	41
Valuation of AFS fin. assets	0	0	0	0	0	Capital surplus	131	131	131	131	131
Other compreh. income	0	0	0	0	0	Retained earnings	678	717	966	1,046	1,244
Comprehensive income	173	118	249	245	291	Other capital changes	-101	-85	-85	-85	-85
Comp. income for non-contr. Int.	0	0	0	0	0	Non-controlling interest	0	0	0	0	0
Comp. income for contr. int.	173	118	0	0	0	Total shareholder's equity	748	803	1,052	1,132	1,330
						Total borrowings	468	434	131	82	-37

Valuation metrics						Cash flow statement					
	(W, x, %)						(Wbn)				
	2011A	2012A	2013F	2014F	2015F		2011A	2012A	2013F	2014F	2015F
EPS	2,296	1,553	3,233	3,174	3,770	Operating cash flows	318	429	416	515	510
PER	15.9	28.0	19.0	19.3	16.3	Net income	177	120	249	245	291
BPS	9,704	10,408	13,641	14,682	17,240	Non-cash items	294	382	268	303	318
PBR	3.8	4.2	4.5	4.2	3.6	Depreciation	152	172	166	166	168
EBITDAPS	6,249	5,754	6,857	7,041	7,643	FX gains	1	0	-1	0	0
EV/EBITDA	6.8	8.5	9.2	8.9	8.0	Equity method gain	0	0	0	0	0
SPS	22,170	23,427	25,205	26,765	28,353	Others	140	210	103	137	149
PSR	1.7	1.9	2.4	2.3	2.1	Chg in assets & liab.	-112	-38	-34	27	-21
CFPS	6,108	6,503	6,708	7,108	7,887	Other cash flows	-42	-35	-67	-59	-77
DPS	1,050	0	2,200	1,250	1,400	Investing cash flow	-344	-301	-142	-265	-266
						Investment assets	-37	-3	126	-7	-8
						Tangible assets	-290	-292	-270	-260	-260
						Others	-16	-7	2	2	2
						Financing cash flows	36	-74	-235	-245	-113
						Short-term borrowings	90	21	-100	-10	-3
						Bonds payable	123	0	-57	15	-70
						Long-term borrowings	30	0	-20	0	-10
						Rights offering	0	0	0	0	0
						Cash dividends	-80	-78	-78	-86	-93
						Others	-127	-17	20	-164	63
						Net chg in cash	8	54	163	-93	116
						Beginning cash balance	56	65	119	282	188
						Ending cash balance	65	119	282	188	305
						NOPLAT	191	169	223	253	286
						FCF	37	38	109	149	185

Financial ratios					
	(W, x, %)				
	2011A	2012A	2013F	2014F	2015F
Growth potential					
Sales growth	13.9	5.7	7.6	6.2	5.9
OP growth	-4.4	-6.0	33.1	10.2	13.1
NP growth	-3.4	-32.4	108.2	-1.8	18.8
Profitability					
ROIC	18.7	15.2	18.1	19.8	21.7
ROA	16.5	13.9	17.2	18.7	20.3
ROE	23.9	15.4	26.9	22.4	23.6
Stability					
Debt ratio	110.6	112.0	72.7	55.6	47.7
Net borrowings ratio	62.5	54.1	12.5	7.3	-2.8
Interest coverage ratio	9.6	7.9	16.3	20.3	29.2

Source: Coway, Daishin Securities Research Center

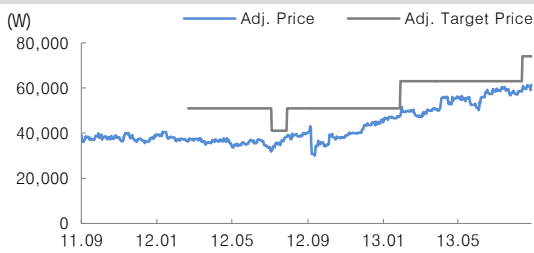
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[Investment rating & Target price history]

Coway (021240)



Date	13.09.23	13.09.03	13.08.06	13.07.08	13.06.30	13.06.03
Rating	Buy	Buy	Buy	Buy	Buy	Buy
TP	74,000	74,000	63,000	63,000	63,000	63,000
Date	13.05.13	13.05.06	13.04.02	13.02.18	12.12.26	12.10.26
Rating	Buy	Buy	Buy	Buy	Buy	Buy
TP	63,000	63,000	63,000	63,000	51,000	51,000
Date	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
TP	51,000	51,000	41,000	41,000	51,000	51,000
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.