

# Coway

(021240 KS)

## A must-have consumer stock

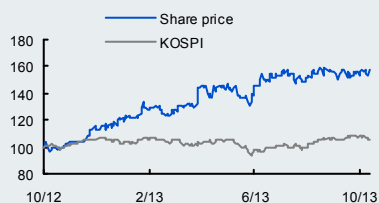
### Consumer Services

Results Comment  
November 11, 2013

(Maintain)	<b>Buy</b>
Target Price (12M, W)	<b>75,000</b>
Share Price (11/08/13, W)	60,500
Expected Return	24%

OP (13F, Wbn)	325
Consensus OP (13F, Wbn)	306
EPS Growth (13F, %)	117.9
Market EPS Growth (13F, %)	16.7
P/E (13F, x)	17.9
Market P/E (13F, x)	10.8
KOSPI	1,984.87
Market Cap (Wbn)	4,666
Shares Outstanding (mn)	77
Free Float (%)	65.6
Foreign Ownership (%)	53.3
Beta (12M)	0.26
52-Week Low (W)	37,000
52-Week High (W)	63,400

(%)	1M	6M	12M
Absolute	0.0	12.9	58.6
Relative	0.9	11.4	54.9



Daewoo Securities Co., Ltd.

Textile/Apparel, Hotel/Leisure

Regina Hahm

+822-768-4172

regina.hahm@dwsec.com

### 3Q13 review: Positive earnings surprise with larger-than-expected margin gain

On a non-consolidated basis, Coway posted 3Q preliminary revenue of W489.2bn (+6.8% YoY), operating profit of W97bn (+54.2% YoY) and OP margin of 19.8%. Operating profit sharply surprised to the upside, beating our estimate of W80.3bn (OP margin of 16.3%) and the market consensus of W77.9bn (OP margin of 15.7%). We believe Coway's profit-oriented business strategy following its acquisition by MBK Partners is yielding stronger-than-expected results.

The rental unit saw 18,000 net subscriber additions in 3Q, slightly lower than the 23,000 additions in 2Q. We believe this was due to consumer backlash against the rental and membership price hikes made in 2Q. However, subscriber churn and rental asset disposals, key indicators of product quality and customer satisfaction, continued to improve to record-low levels. We believe the improvement of these factors contributed to overall margin gains and profit growth.

### Rental and overseas businesses performing better than management guidance

Coway seems to be on track to achieve its guidance for earnings, profitability and net subscriber additions set earlier this year. In 3Q, cumulative net subscriber additions reached 139,000, or 89.1% of the firm's annual guidance (156,000). As of 3Q, OP margin has averaged 16.4% YTD, rising faster than the firm's original guidance (15%).

Coway's overseas business, one of the company's mid/long-term growth drivers, is also expanding faster than expected. ODM sales to global appliance makers continued to grow in 3Q, surging 73.7% YoY. Exports to overseas subsidiaries soared 151.2% YoY, aided by the robust performance of the firm's major subsidiaries. On a cumulative basis, overseas revenue contributed 7.8% of overall revenue in 3Q13, up from 5.3% in 3Q12. We expect overseas revenue to continue high growth over the mid- to long-term and account for 11.4% of overall revenue in 2014.

### Stable business portfolio stands out

One of Coway's biggest strengths is its rental business' ability to deliver stable growth in a low-growth environment because of its low cost burden on customers. In our view, the company deserves a premium for its solid top-line growth potential. More importantly, profit growth has been outpacing revenue growth thanks to aggressive SG&A cost reductions and improved asset quality. We thus believe overvaluation pressures will further ease going forward.

We believe Coway will achieve a differentiated position in the domestic consumer services universe on the back of its abundant cash flow and profit growth. The newly independent company has been blazing a promising trail this year following its separation from the Woongjin Group. We maintain our Buy call on Coway with a target price of W75,000.

FY (Dec.)	12/10	12/11	12/12	12/13F	12/14F	12/15F
Revenue (Wbn)	1,502	1,710	1,807	1,942	2,089	2,254
OP (Wbn)	254	243	228	325	353	392
OP Margin (%)	16.9	14.2	12.6	16.7	16.9	17.4
NP (Wbn)	183	177	120	261	260	292
EPS (W)	2,376	2,296	1,553	3,383	3,376	3,783
ROE (%)	26.0	24.0	15.4	30.5	26.0	24.5
P/E (x)	17.0	15.9	28.1	17.9	17.9	16.0
P/B (x)	5.1	4.0	4.6	5.5	4.6	3.8

Notes: All figures are based on consolidated K-IFRS; NP refers to net profit attributable to controlling interests  
Source: Company data, KDB Daewoo Securities Research estimates

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Table 1. 3Q13P earnings results

(Wbn, %)

	3Q12	2Q13	3Q13P			Growth	
			Preliminary	KDB Daewoo	Consensus	YoY	QoQ
Revenue	458	497	489	492	495	6.8	-1.6
Operating profit	62	79	97	80	78	56.4	22.2
OP margin	13.5	16.0	19.8	16.3	15.7		
Pretax profit	53	81	83	80	75	56.0	2.8
Net profit	40	61	62	60	57	56.5	2.9

Notes: K-IFRS non-consolidated; The provisional allowance (W35.5bn) for the Japanese subsidiary in the process of liquidation was added back to 3Q12 pretax profit and net profit figures

Source: Company data, KDB Daewoo Securities Research estimates

Table 2. Earnings forecast revisions

(Wbn, %)

	Previous		Revised		Change	
	13F	14F	13F	14F	13F	14F
Revenue	1,946	2,101	1,942	2,089	-0.2	-0.6
Operating profit	307	346	325	353	5.8	2.0
OP margin	15.8	16.5	16.7	16.9		
Pretax profit	353	349	356	347	0.7	-0.5
Net profit	259	262	261	260	0.7	-0.5
EPS	3,360	3,392	3,383	3,376	0.7	-0.5

Notes: K-IFRS non-consolidated

Source: Company data, KDB Daewoo Securities Research estimates

Table 3. Quarterly earnings forecast

(Wbn, %)

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13F
<b>Revenue</b>	<b>442</b>	<b>446</b>	<b>458</b>	<b>460</b>	<b>465</b>	<b>497</b>	<b>489</b>	<b>491</b>
(%, YoY)	10.6	2.4	6.5	3.6	5.2	11.3	6.8	6.7
<b>Rental revenue</b>	<b>316</b>	<b>319</b>	<b>323</b>	<b>327</b>	<b>327</b>	<b>332</b>	<b>335</b>	<b>341</b>
<b>Membership revenue</b>	<b>39</b>	<b>39</b>	<b>41</b>	<b>42</b>	<b>43</b>	<b>43</b>	<b>43</b>	<b>45</b>
<b>Outright sale revenue</b>	<b>87</b>	<b>88</b>	<b>94</b>	<b>90</b>	<b>95</b>	<b>122</b>	<b>111</b>	<b>105</b>
Environmental appliances	17	18	15	16	16	15	9	14
Mattresses	0	0	2	2	2	2	2	2
Outsourced products	16	23	22	14	18	31	24	15
Exports	30	21	28	31	31	45	38	46
Cosmetics	17	16	17	17	18	22	17	18
Other	8	10	9	11	9	8	21	11
<b>Revenue contribution</b>								
Rental	71.5	71.4	70.6	71.2	70.4	66.8	68.5	69.5
Membership	8.8	8.8	9.0	9.2	9.2	8.6	8.8	9.1
Outright sale	19.7	19.8	20.5	19.7	20.4	24.6	22.7	21.4
<b>Gross profit</b>	<b>297</b>	<b>304</b>	<b>306</b>	<b>294</b>	<b>311</b>	<b>329</b>	<b>319</b>	<b>322</b>
(%, YoY)	8.2	3.3	3.8	0.1	4.6	8.1	4.2	9.6
<b>SG&amp;A</b>	<b>233</b>	<b>239</b>	<b>244</b>	<b>258</b>	<b>241</b>	<b>250</b>	<b>222</b>	<b>242</b>
(%, YoY)	6.8	2.7	4.1	12.2	3.7	4.4	-8.7	-6.1
<b>Operating profit</b>	<b>64</b>	<b>65</b>	<b>63</b>	<b>36</b>	<b>69</b>	<b>79</b>	<b>97</b>	<b>80</b>
(%, YoY)	13.6	5.4	2.4	-44.0	7.9	21.9	54.2	122.9
<b>Pretax profit</b>	<b>56</b>	<b>56</b>	<b>18</b>	<b>32</b>	<b>115</b>	<b>81</b>	<b>83</b>	<b>77</b>
(%, YoY)	10.3	2.5	-72.6	-42.5	106.7	43.1	369.0	143.1
<b>Net profit</b>	<b>41</b>	<b>44</b>	<b>13</b>	<b>22</b>	<b>80</b>	<b>61</b>	<b>62</b>	<b>58</b>
(%, YoY)	6.4	4.6	-73.7	-54.2	94.5	37.6	382.4	168.2
<b>Profitability</b>								
GP margin	67.1	68.2	66.9	63.9	66.8	66.2	65.3	65.6
OP margin	14.5	14.6	13.7	7.8	14.9	16.0	19.8	16.2
Pretax margin	12.6	12.6	3.9	6.9	24.7	16.2	17.0	15.7
Net margin	9.3	9.9	2.8	4.7	17.2	12.2	12.7	11.8

Notes: K-IFRS non-consolidated

Source: Company data, KDB Daewoo Securities Research

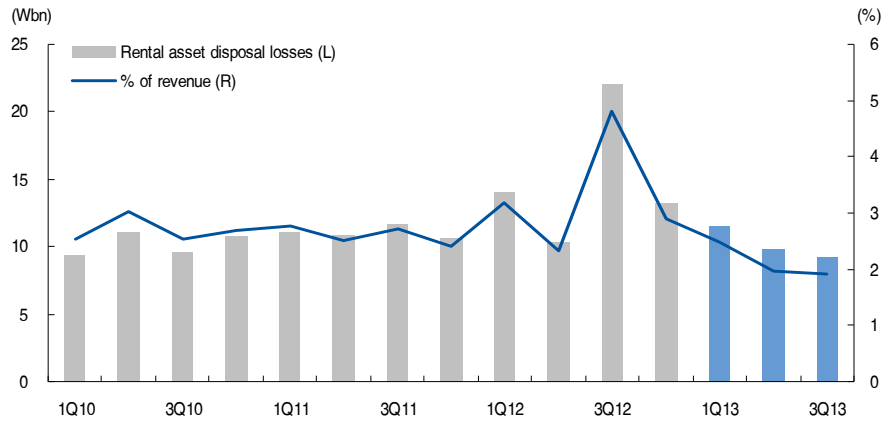
**Table 4. Annual earnings forecast** ('000 accounts, %, Wbn)

	11	12	13F	14F	15F
Total accounts	5,452	5,741	5,966	6,041	6,169
Rental accounts	4,450	4,607	4,787	4,820	4,911
Membership	1,002	1,133	1,179	1,221	1,258
Monthly average customer churn rate	1.04	1.01	0.92	0.86	0.85
Customer retention rate	79.3	82.0	78.6	79.6	80.7
<b>Revenue</b>	<b>1,710</b>	<b>1,807</b>	<b>1,942</b>	<b>2,089</b>	<b>2,254</b>
Rental	1,206	1,286	1,335	1,371	1,431
Membership	161	161	173	182	187
Outright sale	343	360	434	536	636
Environmental appliances	138	66	53	50	48
Mattresses	0	5	8	8	9
Outsourced products	77	104	119	138	161
Exports	98	110	160	240	312
Cosmetics	68	67	74	82	90
Other	38	38	49	49	49
<b>% YoY</b>					
Revenue	12.6	5.7	7.5	7.6	7.9
Rental	9.0	6.6	3.8	2.7	4.4
Monthly rental fees	11.0	7.4	4.6	2.5	4.4
Rental registration fees	-34.5	-23.4	-35.1	19.3	4.6
Membership	8.8	0.3	7.4	5.1	2.8
Outright sale	29.3	5.0	20.5	23.6	18.6
<b>Gross profit</b>	<b>1,158</b>	<b>1,201</b>	<b>1,281</b>	<b>1,343</b>	<b>1,432</b>
(%, YoY)	13.0	3.8	6.6	4.9	6.6
<b>SG&amp;A</b>	<b>915</b>	<b>974</b>	<b>956</b>	<b>990</b>	<b>1,040</b>
(%, YoY)	14.9	6.5	-1.8	3.6	5.0
<b>Operating profit</b>	<b>243</b>	<b>228</b>	<b>325</b>	<b>353</b>	<b>392</b>
(%, YoY)	6.4	-6.4	42.7	8.6	11.0
<b>Pretax profit</b>	<b>225</b>	<b>161</b>	<b>355</b>	<b>347</b>	<b>389</b>
(%, YoY)	-4.7	-28.3	119.8	-2.2	12.1
<b>Net profit</b>	<b>177</b>	<b>120</b>	<b>260</b>	<b>260</b>	<b>292</b>
(%, YoY)	0.0	-32.4	117.1	0.1	12.1
<b>[Profitability]</b>					
GP margin	67.7	66.5	66.0	64.3	63.5
OP margin	14.2	12.6	16.7	16.9	17.4
Pretax margin	13.2	8.9	18.3	16.6	17.3
Net margin	10.4	6.6	13.4	12.5	12.9

Notes: K-IFRS non-consolidated

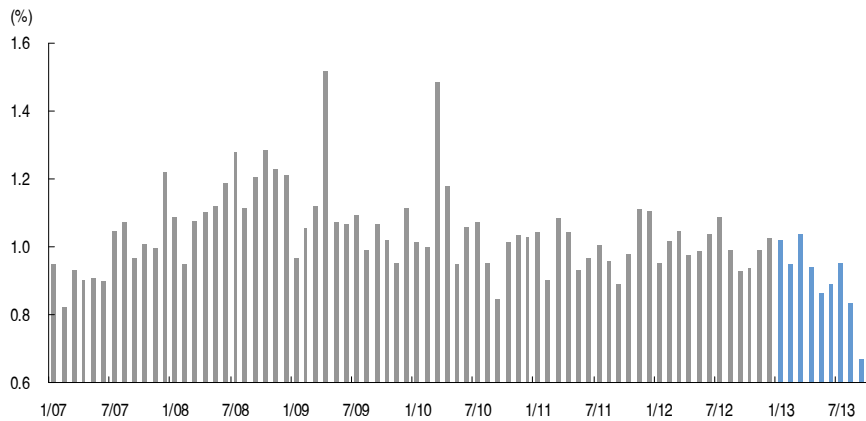
Source: Company data, KDB Daewoo Securities Research

**Figure 1. Rental asset disposal losses have continuously contracted QoQ**



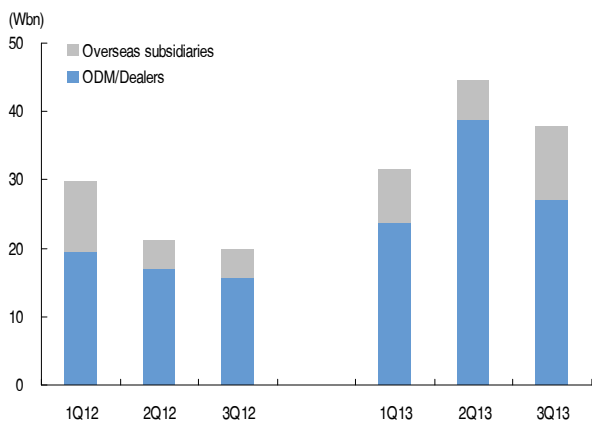
Source: Company data, KDB Daewoo Securities Research

**Figure 2. Monthly average churn rate reached another new record-low**



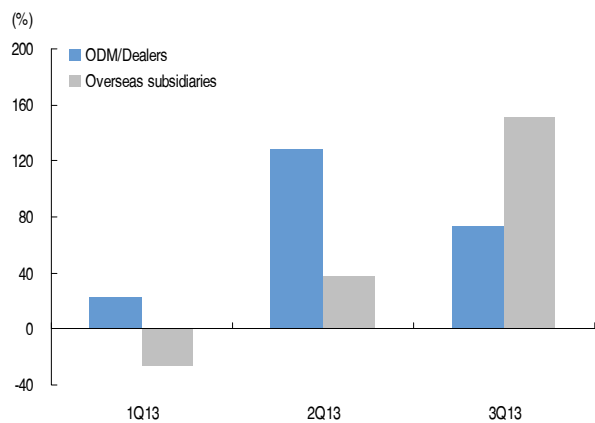
Source: Company data, KDB Daewoo Securities Research

**Figure 3. Quarterly revenue from overseas business**



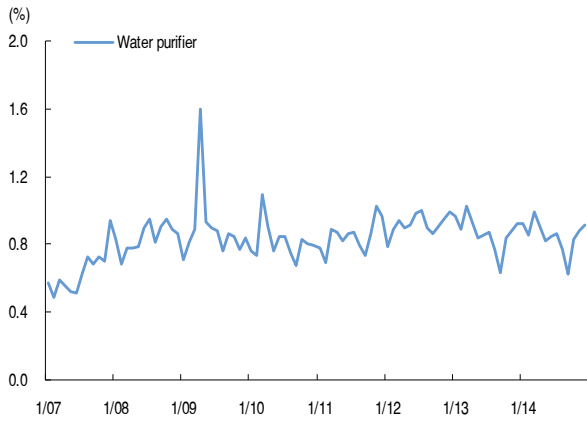
Source: Company data, KDB Daewoo Securities Research

**Figure 4. YoY growth of overseas business**



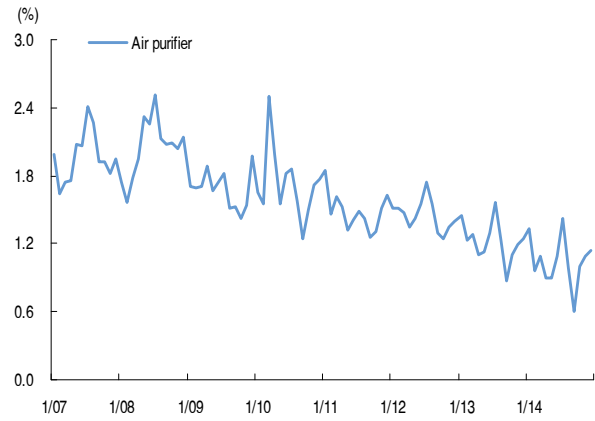
Source: Company data, KDB Daewoo Securities Research

**Figure 5. Monthly cancellation rate trend (Water purifier)**



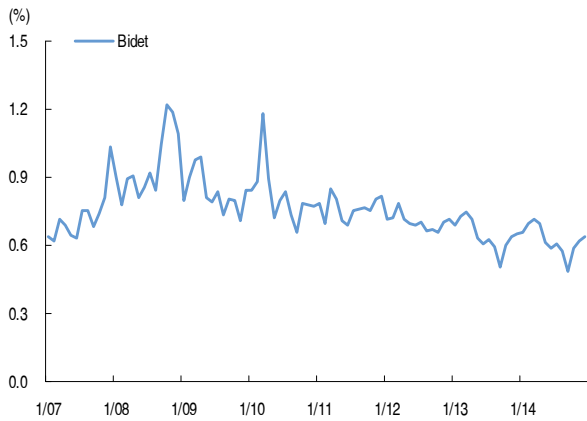
Source: Company data, KDB Daewoo Securities Research

**Figure 6. Monthly cancellation rate trend (Air purifier)**



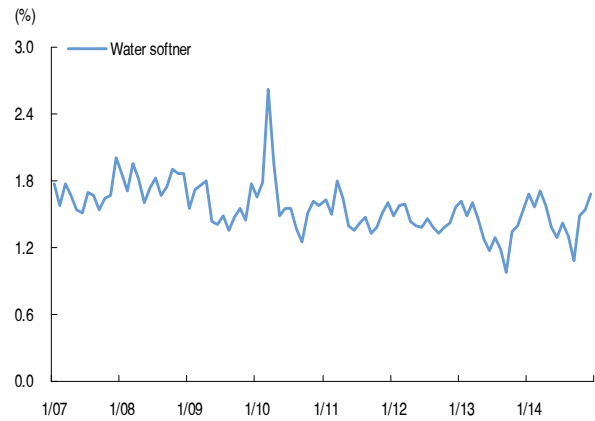
Source: Company data, KDB Daewoo Securities Research

**Figure 7. Monthly cancellation rate trend (Bidet)**



Source: Company data, KDB Daewoo Securities Research

**Figure 8. Monthly cancellation rate trend (Water softner)**



Source: Company data, KDB Daewoo Securities Research

## COWAY (021240 KS/Buy/TP: W75,000)

## Comprehensive Income Statement (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
<b>Revenue</b>	<b>1,807</b>	<b>1,942</b>	<b>2,089</b>	<b>2,254</b>
<b>Cost of Sales</b>	<b>605</b>	<b>661</b>	<b>745</b>	<b>822</b>
<b>Gross Profit</b>	<b>1,201</b>	<b>1,281</b>	<b>1,344</b>	<b>1,432</b>
<b>SG&amp;A Expenses</b>	<b>974</b>	<b>956</b>	<b>990</b>	<b>1,040</b>
<b>Operating Profit (Adj)</b>	<b>228</b>	<b>325</b>	<b>353</b>	<b>392</b>
<b>Operating Profit</b>	<b>228</b>	<b>325</b>	<b>353</b>	<b>392</b>
<b>Non-Operating Profit</b>	<b>-66</b>	<b>31</b>	<b>-6</b>	<b>-3</b>
Net Financial Income	27	15	8	5
Net Gain from Inv in Associates	-3	45	0	0
Pretax Profit	162	356	347	389
Income Tax	42	95	87	97
Profit from Continuing Operations	<b>120</b>	<b>261</b>	<b>260</b>	<b>292</b>
Profit from Discontinued Operations	0	0	0	0
<b>Net Profit</b>	<b>120</b>	<b>261</b>	<b>260</b>	<b>292</b>
Controlling Interests	120	261	260	292
Non-Controlling Interests	0	0	0	0
<b>Total Comprehensive Profit</b>	<b>118</b>	<b>260</b>	<b>259</b>	<b>291</b>
Controlling Interests	118	260	259	291
Non-Controlling Interests	0	0	0	0
EBITDA	400	412	529	575
FCF (Free Cash Flow)	45	62	189	218
EBITDA Margin (%)	22.1	21.2	25.3	25.5
Operating Profit Margin (%)	12.6	16.7	16.9	17.4
Net Profit Margin (%)	6.6	13.4	12.5	13.0

## Cash Flows (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
<b>Cash Flows from Op Activities</b>	<b>413</b>	<b>572</b>	<b>433</b>	<b>466</b>
Net Profit	120	261	260	292
Non-Cash Income and Expense	382	290	269	284
Depreciation	165	83	169	176
Amortization	7	4	7	7
Others	-137	-147	0	0
Chg in Working Capital	-54	87	-9	-13
Chg in AR & Other Receivables	-56	-40	-24	-27
Chg in Inventories	25	1	-3	-4
Chg in AP & Other Payables	0	141	13	15
Income Tax Paid	-35	-65	-87	-97
<b>Cash Flows from Inv Activities</b>	<b>-301</b>	<b>-52</b>	<b>-226</b>	<b>-230</b>
Chg in PP&E	-292	-230	-224	-229
Chg in Intangible Assets	-8	-6	-6	-6
Chg in Financial Assets	-1	2	0	0
Others	0	182	4	4
<b>Cash Flows from Fin Activities</b>	<b>-57</b>	<b>-392</b>	<b>-92</b>	<b>13</b>
Chg in Financial Liabilities	37	-220	-52	-34
Chg in Equity	12	2	0	0
Dividends Paid	-78	-78	-82	-82
Others	-29	-18	-12	-9
<b>Increase (Decrease) in Cash</b>	<b>54</b>	<b>130</b>	<b>116</b>	<b>249</b>
Beginning Balance	65	119	249	365
Ending Balance	119	249	365	614

Source: Company data, KDB Daewoo Securities Research estimates

## Statement of Financial Condition (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
<b>Current Assets</b>	<b>691</b>	<b>739</b>	<b>891</b>	<b>1,180</b>
Cash and Cash Equivalents	119	249	365	614
AR & Other Receivables	291	315	338	366
Inventories	41	44	47	51
Other Current Assets	239	116	125	135
<b>Non-Current Assets</b>	<b>1,010</b>	<b>1,037</b>	<b>1,097</b>	<b>1,154</b>
Investments in Associates	0	0	0	0
Property, Plant and Equipment	594	626	681	733
Intangible Assets	158	155	154	152
<b>Total Assets</b>	<b>1,702</b>	<b>1,776</b>	<b>1,987</b>	<b>2,335</b>
<b>Current Liabilities</b>	<b>720</b>	<b>801</b>	<b>771</b>	<b>760</b>
AP & Other Payables	166	170	183	197
Short-Term Financial Liabilities	439	541	491	458
Other Current Liabilities	115	91	98	106
<b>Non-Current Liabilities</b>	<b>179</b>	<b>63</b>	<b>128</b>	<b>277</b>
Long-Term Financial Liabilities	<b>154</b>	<b>5</b>	<b>58</b>	<b>194</b>
Other Non-Current Liabilities	15	35	35	35
<b>Total Liabilities</b>	<b>899</b>	<b>865</b>	<b>899</b>	<b>1,037</b>
<b>Controlling Interests</b>	<b>803</b>	<b>911</b>	<b>1,089</b>	<b>1,297</b>
Capital Stock	<b>41</b>	<b>41</b>	<b>41</b>	<b>41</b>
Capital Surplus	131	131	131	131
Retained Earnings	717	821	1,000	1,210
<b>Non-Controlling Interests</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Stockholders' Equity</b>	<b>803</b>	<b>911</b>	<b>1,089</b>	<b>1,297</b>

## Forecasts/Valuations (Summarized)

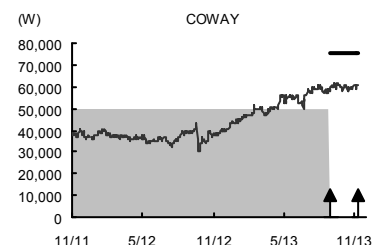
	12/12	12/13F	12/14F	12/15F
P/E (x)	28.1	17.9	17.9	16.0
P/CF (x)	11.5	13.4	10.7	9.8
P/B (x)	4.6	5.5	4.6	3.8
EV/EBITDA (x)	9.6	12.1	9.2	8.2
EPS (W)	1,553	3,383	3,376	3,783
CFPS (W)	3,781	4,511	5,658	6,156
BPS (W)	9,541	10,946	13,263	15,983
DPS (W)	0	2,100	1,100	1,100
Payout ratio (%)	0.0	30.0	31.4	28.1
Dividend Yield (%)	0.0	3.5	1.8	1.8
Revenue Growth (%)	5.7	7.5	7.6	7.9
EBITDA Growth (%)	1.0	3.1	28.4	8.7
Operating Profit Growth (%)	-6.4	42.7	8.6	11.1
EPS Growth (%)	-32.4	117.9	-0.2	12.1
Accounts Receivable Turnover (x)	6.9	6.7	6.7	6.7
Inventory Turnover (x)	31.6	45.5	45.7	45.7
Accounts Payable Turnover (x)	58.5	60.3	62.3	62.4
ROA (%)	7.3	15.0	13.8	13.5
ROE (%)	15.4	30.5	26.0	24.5
ROIC (%)	17.2	23.1	23.9	24.9
Liability to Equity Ratio (%)	112.0	94.9	82.5	80.0
Current Ratio (%)	96.1	92.2	115.6	155.2
Net Debt to Equity Ratio (%)	58.9	30.9	15.4	1.8
Interest Coverage Ratio (x)	7.9	18.0	29.7	43.1

# APPENDIX 1

## Important Disclosures & Disclaimers

### Disclosures

As of the publication date, Daewoo Securities Co., Ltd and/or its affiliates do not have any special interest with the subject company and do not own 1% or more of the subject company's shares outstanding.



Stock Ratings		Industry Ratings	
Buy	Relative performance of 20% or greater	Overweight	Fundamentals are favorable or improving
Trading Buy	Relative performance of 10% or greater, but with volatility	Neutral	Fundamentals are steady without any material changes
Hold	Relative performance of -10% and 10%	Underweight	Fundamentals are unfavorable or worsening
Sell	Relative performance of -10%		

\* Ratings and Target Price History (Share price (---), Target price (----), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))

\* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.

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**KDB Daewoo Securities International Network****Daewoo Securities Co. Ltd. (Seoul)**

Head Office  
34-3 Yeouido-dong, Yeongdeungpo-gu  
Seoul 150-716  
Korea  
Tel: 82-2-768-3026

**Daewoo Securities (Hong Kong) Ltd.**

Two International Finance Centre  
Suites 2005-2012  
8 Finance Street, Central  
Hong Kong  
Tel: 85-2-2514-1304

**Daewoo Securities (America) Inc.**

320 Park Avenue, 31st Fl.  
New York, NY 10022  
United States  
Tel: 1-212-407-1000

**Daewoo Securities (Europe) Ltd.**

Tower 42, Level 41  
25 Old Broad Street  
London EC2N 1HQ  
United Kingdom  
Tel: 44-20-7982-8016

**Daewoo Securities (Singapore) Pte. Ltd.**

6 Battery Road, #11-01  
Singapore, 049909  
Tel: 65-6671-9845

**Tokyo Representative Office**

7th Floor, Yusen Building  
2-3-2 Marunouchi, Chiyoda-ku  
Tokyo 100-0005  
Japan  
Tel: 81-3- 3211-5511

**Beijing Representative Office**

Suite 2602, Twin Towers (East)  
B-12 Jianguomenwai Avenue  
Chaoyang District, Beijing 100022  
China  
Tel: 86-10-6567-9699

**Shanghai Representative Office**

Unit 13, 28<sup>th</sup> Floor, Hang Seng Bank Tower  
1000 Lujiazui Ring Road  
Pudong New Area, Shanghai 200120  
China  
Tel: 86-21-5013-6392

**Ho Chi Minh Representative Office**

Centec Tower  
72-74 Nguyen Thi Minh Khai Street  
Ward 6, District 3, Ho Chi Minh City  
Vietnam  
Tel: 84-8-3910-6000