

Coway (021240)

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Rating **BUY**

maintain

6M TP (W) **76,000**

raise

CP (W) **60,500**
(13.11.08)

Service

Coway shines through gloom

- Coway's 3Q13 earnings surprised on the upside with an all-time high quarterly OP
- 3Q earnings overshoot: sales W489.2bn (+6.8% YoY), OP W97bn (+54.2% YoY), NP W62.3bn (+382.2% YoY). OP and NP beat our estimates by 25% and 13% respectively.
 - Rental cancellation rates were lowest at 0.82% in reflection of better product and service quality.
 - The all-time high OP came on the back of cost reductions, SG&A expense controls and lower rental equipment impairment costs.
 - On a consolidated basis, earnings came in weaker due to the sluggish performance of the cosmetics division in China: sales W530.5bn (+4.7% YoY), OP W93.6bn (+53.3% YoY), NP W60.1bn (+40.4 YoY).

Margin expansion will be sustained on price hikes in 2014

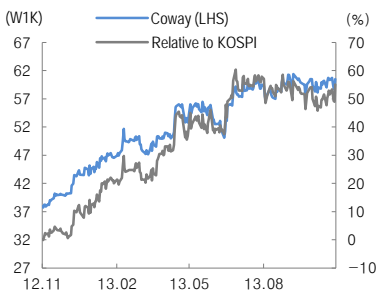
- OP is forecast to jump 132% on cost reductions, SG&A expense controls, and the lower comparison base.
- Drastic cost reductions and free-of-charge after-sales service cutbacks resulted in weaker net order growth. Net order growth will recover as the company introduces new products and diversifies its product mix, while expanding sales channels.
- OEM production of JuicePresso, mattresses, and massaging chairs will boost sales and margins.
- Coway will likely shut down its cosmetics operations in China. The Thailand subsidiary is going through an overhaul. The Japanese operations are set for closure. The company's bottom line will strengthen.
- Price hike effects will be felt in 2014. Despite higher SG&A expenses expected with new products rollouts, sales and OP will grow 6% and 10%, respectively, in 2014

Maintain BUY and raise our TP to W76,000

- We raise 2014E and 2015E EPS 5% and 3% respectively, assuming SG&A expense increases in 2014. We may raise our earnings forecast substantially, should the SG&A expense growth is curbed and net order growth recovers.
- Coway's growth potential is growing through domestic partnership deals based on its door-to-door marketing channels.
- Coway's year-end dividend is forecast at W1,100. The W50bn-worth share buyback launched last October will add to the stock's downside support.
- Coway is undervalued relative to its peers such as AmorePacfic, LG Household & Healthcare, Lock & Lock, and S1, despite superior earnings momentum. Robust earnings will sustain stock price upside.

KOSPI	1984.87
Market cap (Wbn)	4,666
Market cap portion (%)	0.40
Paid-in capital (common; Wbn)	41
52W high/low (W)	61,400 / 37,700
120d avg. trading volume (Wbn)	9.6
Foreign ownership (%)	53.25
Major shareholders	Coway Holdings +16: 31.05% Lazard Asset Management LLC+33: 9.91%

(%)	1M	3M	6M	12M
Abs. return	0.0	2.9	12.9	58.6
Rel. return	0.9	-2.3	11.3	53.0



	3Q12	2Q13	3Q13				4Q13			
			Consensus	Previous estimates	Results	YoY	QoQ	Our estimates	YoY	QoQ
Sales	458	497	495	491	489	6.8	-1.6	487	5.8	-0.5
OP	63	79	77	78	97	54.3	22.3	83	TTB	-14.8
NP	13	61	56	55	62	382.2	2.8	55	155.4	-11.4

	2011	2012	2013(F)			Chg (%)	Growth	
			Consensus	Previous estimates	Our estimates		2012	2013(F)
Sales	1,710	1,807	1,958	1,944	1,938	-0.3	5.7	7.3
OP	242	228	298	303	328	8.3	-6.0	44.1
NP	177	120	256	249	258	3.5	-32.4	115.6

Source: Coway, WISEfn, Daishin Securities Research Center

Tab 1. 3Q results (non-consolidated)

(Wbn, %)

	3Q13P	3Q12	YoY(%)	2Q13	QoQ(%)	Our est.	Var.(%)	Cons.	Var.(%)
Sales	489.2	458.0	6.8	496.9	(1.6)	491.3	(0.4)	495.0	(1.2)
OP	97.0	62.9	54.2	79.4	22.3	77.8	24.7	76.9	26.2
NP	62.3	12.9	382.2	60.6	2.8	55.1	12.9	57.3	8.6
OP margin (%)	19.8	13.7		16.0		15.8		15.5	
NP margin (%)	12.7	2.8		12.2		11.2		11.6	

Source: Daishin Securities Research Center

Tab 2. 3Q results (consolidated)

(Wbn, %)

	3Q13P	3Q12	YoY(%)	differences with non-consolidated figures
Sales	530.5	506.5	4.7	41.3
OP	96.3	62.8	53.3	(0.7)
NP	60.1	42.8	40.4	(2.2)
OP margin (%)	18.2	12.4		
NP margin (%)	11.3	8.5		

Source: Daishin Securities Research Center

Tab 3. 3Q13 results by division (non-consolidated)

(Wbn, %)

		3Q13P	3Q12	YoY(%)	2Q12	QoQ(%)
Sales	Total	489.2	458.0	6.8	496.9	(1.6)
	Rental	334.9	323.2	3.6	331.9	0.9
	Membership	43.2	41.1	5.1	42.8	1.0
	Lump-sum payment	35.4	39.1	(9.3)	47.8	(25.9)
	Overseas	38.0	28.0	35.6	44.6	(14.8)
	Cosmetics	16.6	17.3	(4.2)	22.1	(25.1)
	Others	21.1	9.4	125.6	7.8	172.7
	GP	Total	319.3	306.5	4.2	329.0
Rental		239.8	231.8	3.5	237.7	0.9
Membership		30.3	28.1	7.7	28.7	5.5
Lump-sum payment		21.4	23.5	(8.9)	28.4	(24.5)
Overseas		9.0	5.2	70.9	11.8	(23.8)
Cosmetics		14.2	14.3	(1.0)	18.9	(25.1)
Others		4.6	3.5	32.0	3.6	30.3
GP margin (%)		Total	65.3	66.9		66.2
	Rental	71.6	71.7		71.6	
	Membership	70.1	68.4		67.1	
	Lump-sum payment	60.5	60.2		59.4	
	Overseas	23.6	18.7		26.4	
	Cosmetics	85.5	82.8		85.5	
	Others	22.0	37.6		46.0	

Source: Daishin Securities Research Center

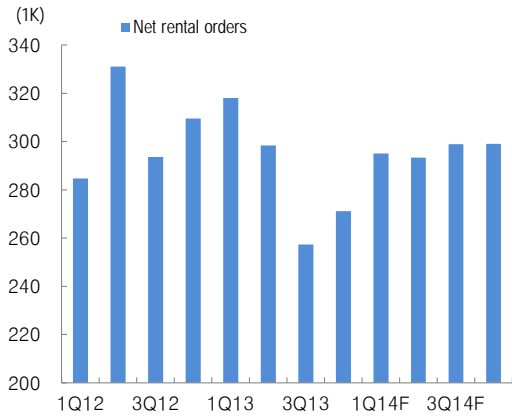
Tab 4. Coway quarterly and annual earnings trend and forecast

(Wbn, %)

		1Q13	2Q13	3Q13	4Q13F	1Q14F	2Q14F	3Q14F	4Q14F	2012	2013F	2014F	2015F
Rental orders ('000)		318.0	298.4	257.4	271.1	295.0	293.3	299.0	299.1	1,218.9	1,144.9	1,186.3	1,223.0
Monthly cancellation rate (%)		1.01%	0.90%	0.82%	0.89%	0.89%	0.89%	0.87%	0.89%	1.01%	0.92%	0.90%	0.87%
Rental accounts ('000)		4,657.8	4,716.8	4,746.4	4,774.0	4,825.7	4,868.3	4,919.5	4,941.0	4,607.4	4,774.0	4,941.0	5,108.4
Membership accounts		1,135.3	1,099.6	1,087.7	1,089.4	1,095.3	1,108.4	1,120.9	1,138.0	1,133.1	1,089.4	1,138.0	1,191.3
Total customer accounts		5,793.1	5,816.4	5,834.1	5,863.5	5,921.0	5,976.7	6,040.4	6,079.0	5,740.5	5,863.5	6,079.0	6,299.6
Chg in total customer accts.		52.6	23.3	17.7	29.4	57.6	55.7	63.6	38.6	288.5	122.9	215.5	220.7
Sales	Total	465.2	496.9	489.2	486.9	497.2	525.7	519.0	517.0	1,806.8	1,938.3	2,059.0	2,182.4
	Rental	327.4	331.9	334.9	338.0	342.4	346.9	351.4	355.2	1,285.7	1,332.2	1,395.9	1,459.7
	Membership	42.8	42.8	43.2	43.3	43.7	44.3	45.0	45.8	161.3	172.0	178.8	191.8
	Bullet payment	36.6	47.8	35.4	32.7	39.5	46.1	39.9	35.0	144.7	152.6	160.5	170.4
	Others	40.5	52.3	59.1	56.2	52.9	65.2	64.8	62.9	155.5	208.2	245.8	276.2
	Cosmetics	17.9	22.1	16.6	16.8	18.7	23.2	17.9	18.1	67.2	73.4	78.0	84.3
YoY (%)	Total	5.2	11.3	6.8	5.8	6.9	5.8	6.1	6.2	5.7	7.3	6.2	6.0
	Rental	3.5	4.1	3.6	3.2	4.6	4.5	4.9	5.1	6.6	3.6	4.8	4.6
	Membership	10.4	9.1	5.1	2.4	2.1	3.6	4.3	6.0	0.3	6.6	4.0	7.2
	Bullet payment	11.9	18.1	(9.3)	0.8	7.9	(3.6)	12.6	6.9	4.7	5.4	5.2	6.2
	Others	7.3	65.9	58.2	36.4	30.6	24.6	9.6	11.8	2.5	33.8	18.1	12.4
	Cosmetics	6.3	35.5	(4.2)	0.0	5.0	5.0	8.0	8.0	(1.4)	9.1	6.4	8.0
GP		310.5	329.0	319.3	324.9	334.2	349.5	346.9	346.0	1,201.4	1,283.8	1,376.6	1,467.7
OP		69.2	79.4	97.0	82.7	84.9	88.9	93.4	92.8	227.8	328.3	359.9	405.5
Pretax profit		115.0	80.7	83.0	72.7	79.8	83.2	86.7	85.6	161.5	351.5	335.3	391.5
NP		80.2	60.6	62.3	55.1	60.5	63.0	65.7	64.9	119.7	258.1	254.1	296.7
YoY (%)	GP	4.6	8.1	4.2	10.6	7.6	6.2	8.6	6.5	3.8	6.9	7.2	6.6
	OP	7.9	21.9	54.2	131.9	22.6	12.0	(3.7)	12.2	(6.4)	44.1	9.7	12.7
	Pretax profit	106.7	43.1	369.2	129.2	(30.6)	3.1	4.4	17.7	(28.3)	117.7	(4.6)	16.8
	NP	94.5	37.6	382.2	155.4	(24.6)	4.1	5.6	17.7	(32.4)	115.6	(1.6)	16.8
GP margin (%)		66.8	66.2	65.3	66.7	67.2	66.5	66.8	66.9	66.5	66.2	66.9	67.3
OP margin (%)		14.9	16.0	19.8	17.0	17.1	16.9	18.0	17.9	12.6	16.9	17.5	18.6
Pretax margin (%)		24.7	16.2	17.0	14.9	16.0	15.8	16.7	16.6	8.9	18.1	16.3	17.9
NP margin (%)		17.2	12.2	12.7	11.3	12.2	12.0	12.7	12.6	6.6	13.3	12.3	13.6

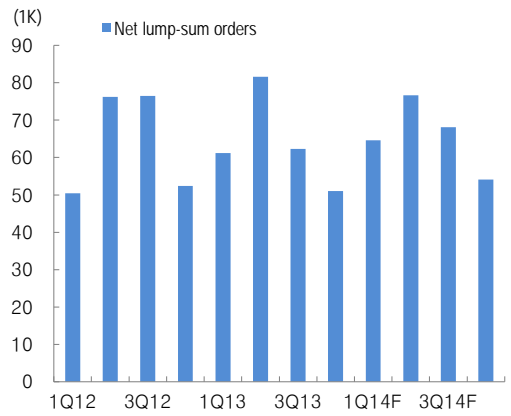
Source: Coway, Daishin Securities Research Center

Fig 1. Quarterly net rental order trend and forecast



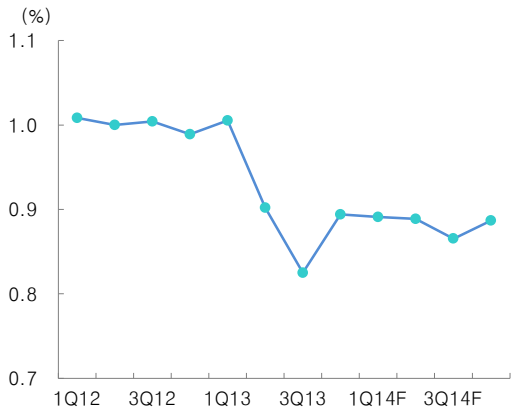
Source: Coway, Daishin Securities Research Center

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



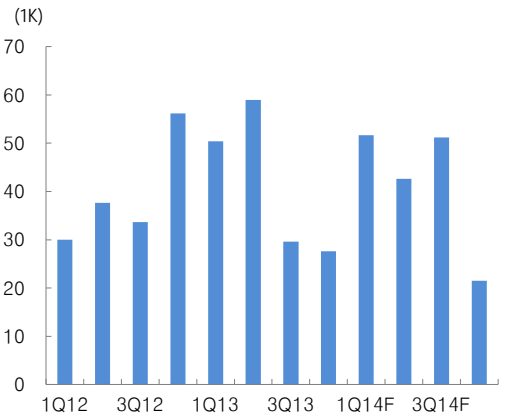
Source: Coway, Daishin Securities Research Center

Fig 3. Monthly average rental cancellation trend and forecast



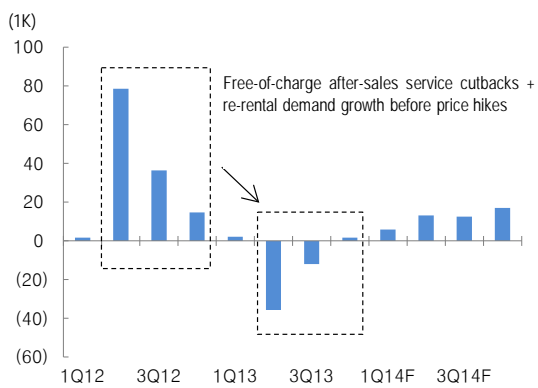
Source: Coway, Daishin Securities Research Center

Fig 4. Quarterly rental account growth trend and forecast



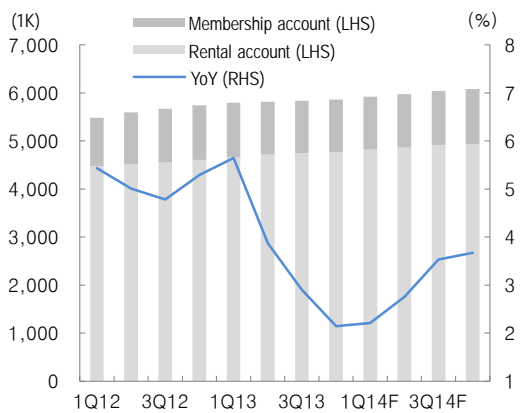
Source: Coway, Daishin Securities Research Center

Fig 5. Quarterly membership growth trend and forecast



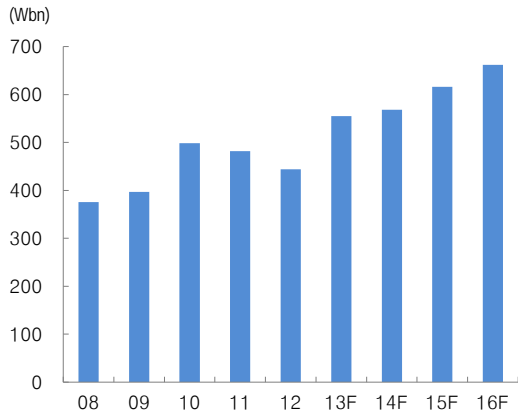
Source: Coway, Daishin Securities Research Center

Fig 6. Quarterly account trend and forecast



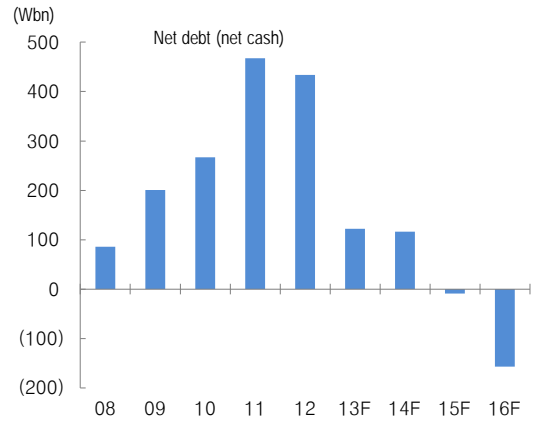
Source: Coway, Daishin Securities Research Center

Fig 7. EBITDA trend and forecast



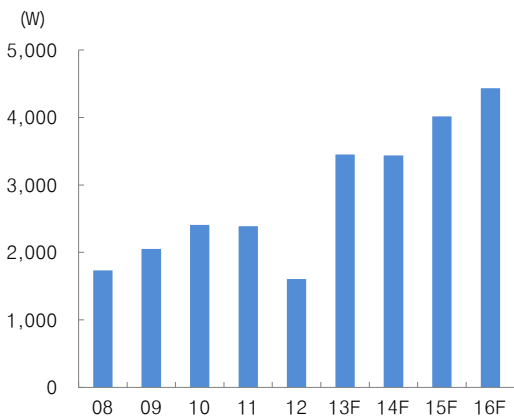
Note: EBITDA = OP + depreciation cost of tangible & intangible assets + rental equipment impairment cost
 Source: Coway, Daishin Securities Research Center

Fig 8. Net debt trend and forecast



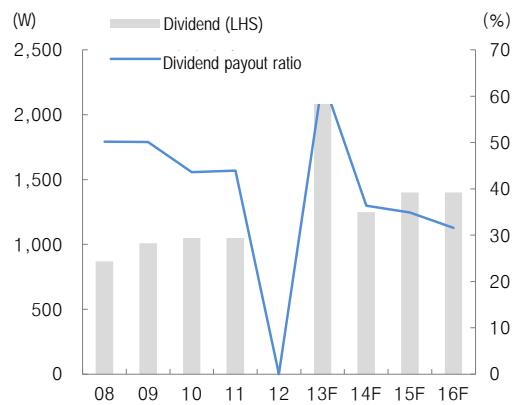
Source: Coway, Daishin Securities Research Center

Fig 9. EPS trend and forecast (excl. treasury shares)



Source: Coway, Daishin Securities Research Center

Fig 10. DPS and payout ratio trend and forecast



Source: Coway, Daishin Securities Research Center

Tab 5. Earnings forecast revision

(Wbn, W, %)

	Previous			Revised			Chg. (%)		
	13F	14F	15F	13F	14F	15F	13F	14F	15F
Sales	1,944	2,064	2,187	1,938	2,059	2,182	(0.3)	(0.3)	(0.2)
OP	303	334	378	328	360	406	8.3	7.7	7.3
Pretax profit	339	323	384	351	335	391	3.7	3.8	2.1
NP	249	245	291	258	254	297	3.5	3.8	2.1
EPS(excl. treasury shares)	3,335	3,274	3,890	3,453	3,438	4,014	3.5	5.0	3.2
YoY(%)									
Sales	7.6	6.2	5.9	7.3	6.2	6.0			
OP	33.1	10.2	13.1	44.1	9.7	12.7			
Pretax profit	109.9	(4.7)	18.8	117.7	(4.6)	16.8			
NP	108.2	(1.8)	18.8	115.6	(1.6)	16.8			
EPS	107.8	(1.8)	18.8	115.1	(0.4)	16.8			
OP margin (%)	15.6	16.2	17.3	16.9	17.5	18.6			
Pretax profit margin (%)	17.4	15.6	17.5	18.1	16.3	17.9			
NP margin (%)	12.8	11.9	13.3	13.3	12.3	13.6			

Source: Daishin Securities Research Center

Tab 6. Valuations

(Wbn, W, X, %)

Target EV (Wbn)	5,706.7	A=a*b
2013E EBITDA	568.4	a
Target EV/EBITDA Multiple	10.0	b
		the average of four domestic peers' 2013E EV/EBITDA
Per-share value (W)	76,000	B=(A-C)/E
Total borrowings	271.5	c
Cash assets + short-term financial assets	155.3	d
Net borrowings (net cash)	116.2	C=c-d
No. of shares issued	77,124,796	e
No. of common shares	3,208,333	f
Adj. no. of common shares	73,916,463	E=e-f
CP (W)	60,500	2013.11.08
Upside (%)	25.6	
2013E Implied P/E (x)	22.1	
2012E Implied P/B (x)	5.4	

Source: Daishin Securities Research Center

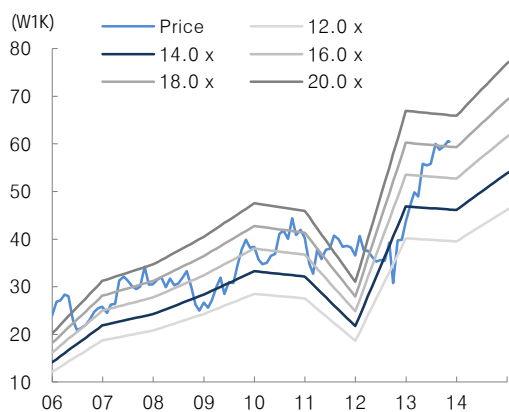
Tab 7. Peer comparison

(X, %)

	Amore Pacific	LG H&H	Lock & Lock	S1	Coway	Avg. except Coway
12M Fwd PER	19.1	23.2	17.1	22.3	18.5	20.4
12-15 EPS 3yrs CAGR (%)	10.9	15.3	19.8	8.4	32.1	13.6
12M Fwd PBR	2.1	5.0	2.0	2.6	4.2	2.9
12M Fwd ROE(%)	11.8	24.9	12.4	13.9	22.9	15.7
12M Fwd EV/EBITDA	9.3	13.5	8.4	8.5	8.8	9.9

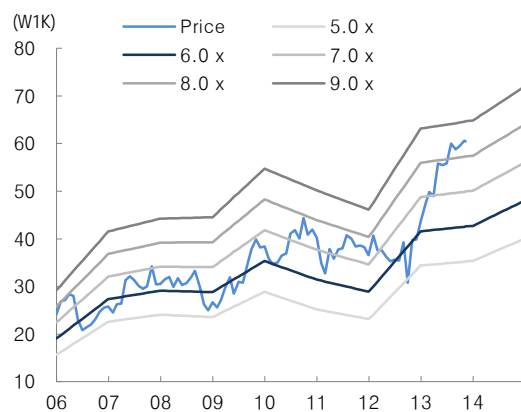
Source: Companies above, Daishin Securities Research Center

Fig 11. 12M Fwd P/E band (non-consolidated)



Source: Coway, Daishin Securities Research Center

Fig 12. 12M Fwd EV/EBITDA band (non-consolidated)



Source: Coway, Daishin Securities Research Center

Financial statements

Income statement		(Wbn)				
	2011A	2012A	2013F	2014F	2015F	
Sales	1,710	1,807	1,938	2,069	2,182	
Cost of goods sold	552	605	654	682	715	
Gross profit	1,158	1,201	1,284	1,377	1,468	
SG&A expenses	869	974	956	1,017	1,062	
OP	242	228	328	360	406	
OP margin	14.2	12.6	16.9	17.5	18.6	
EBITDA	482	444	555	568	616	
Non-OP	-17	-66	-22	-25	-14	
Income from affiliates	0	-3	0	0	0	
Financial revenue	2	4	3	1	1	
FX related gains	9	11	12	0	0	
Financial expense	-26	-62	-19	-16	-13	
FX related losses	0	0	0	0	0	
Others	6	-5	-6	-9	-2	
Income before taxes	225	161	351	335	391	
Income tax expense	-48	-42	-93	-81	-95	
Income from cont. op.	177	120	258	254	297	
Income from discount. op.	0	0	0	0	0	
NP	177	120	258	254	297	
NP margin	10.4	6.6	13.3	12.3	13.6	
NP for non-contr. interest	0	0	0	0	0	
NP for contr. interest	177	120	258	254	297	
Valuation of AFS fin. assets	0	0	0	0	0	
Other compreh. income	0	0	0	0	0	
Comprehensive income	173	118	258	254	297	
Comp. income for non-contr. Int.	0	0	0	0	0	
Comp. income for contr. int.	173	118	0	0	0	

Valuation metrics		(W, x, %)				
	2011A	2012A	2013F	2014F	2015F	
EPS	2,296	1,553	3,347	3,295	3,847	
PER	15.9	28.0	18.1	18.4	15.7	
BPS	9,704	10,408	13,755	14,270	16,919	
PBR	3.8	4.2	4.4	4.2	3.6	
EBITDAPS	6,249	5,754	7,194	7,370	7,990	
EV/EBITDA	6.8	8.5	8.6	8.4	7.6	
SPS	22,170	23,427	25,132	26,697	28,297	
PSR	1.7	1.9	2.4	2.3	2.1	
CFPS	6,108	6,503	7,000	7,247	7,970	
DPS	1,050	0	2,200	1,250	1,400	

Financial ratios		(W, x, %)				
	2011A	2012A	2013F	2014F	2015F	
Growth potential						
Sales growth	13.9	5.7	7.3	6.2	6.0	
OP growth	-4.4	-6.0	44.1	9.7	12.7	
NP growth	-3.4	-32.4	115.6	-1.6	16.8	
Profitability						
ROIC	18.7	15.2	19.5	21.4	23.2	
ROA	16.5	13.9	18.6	20.3	22.1	
ROE	23.9	15.4	27.7	23.5	24.7	
Stability						
Debt ratio	110.6	112.0	72.0	57.2	48.5	
Net borrowings ratio	62.5	54.1	11.5	10.6	-0.7	
Interest coverage ratio	9.6	7.9	17.7	21.9	31.3	

Source: Coway, Daishin Securities Research Center

Balance sheet		(Wbn)				
	2011A	2012A	2013F	2014F	2015F	
Current assets	511	691	867	706	851	
Cash & cash equiv.	65	119	291	155	277	
Trade & other receive.	257	292	313	282	295	
Inventories	73	41	48	48	51	
Other current assets	117	239	215	222	228	
Long-term assets	1,065	1,010	958	1,023	1,087	
Tangible assets	535	594	664	722	777	
Investments in affiliates	237	102	-31	-31	-31	
Other long-term assets	293	314	325	332	341	
Total assets	1,576	1,702	1,825	1,730	1,938	
Current liabilities	534	720	660	509	592	
Payables & other liab.	187	205	202	204	206	
Borrowings	165	296	196	186	183	
Current portion of LT debts	110	110	147	0	80	
Other current liabilities	72	109	116	120	124	
Long-term liabilities	294	179	104	120	41	
Borrowings	267	148	71	86	6	
Convertible securities	0	0	0	0	0	
Other long-term liab.	27	31	33	34	35	
Total liabilities	828	899	764	629	633	
Controlling interest	748	803	1,061	1,101	1,305	
Capital stock	41	41	41	41	41	
Capital surplus	131	131	131	131	131	
Retained earnings	678	717	975	1,065	1,269	
Other capital changes	-101	-85	-85	-135	-135	
Non-controlling interest	0	0	0	0	0	
Total shareholder's equity	748	803	1,061	1,101	1,305	
Total borrowings	468	434	122	116	-9	

Cash flow statement		(Wbn)				
	2011A	2012A	2013F	2014F	2015F	
Operating cash flows	318	429	437	523	515	
Net income	177	120	258	254	297	
Non-cash items	294	382	282	305	318	
Depreciation	152	172	167	168	170	
FX gains	1	0	11	0	0	
Equity method gain	0	0	0	0	0	
Others	140	210	104	137	148	
Chg in assets & liab.	-112	-38	-33	26	-21	
Other cash flows	-42	-35	-70	-62	-79	
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	-195	-112	
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	-92	
Others	-127	-17	20	-114	63	
Net chg in cash	8	54	172	-136	122	
Beginning cash balance	56	65	119	291	155	
Ending cash balance	65	119	291	155	277	
NOPLAT	191	169	241	273	307	
FCF	37	38	128	170	208	

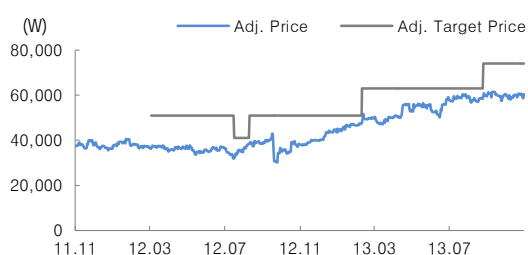
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[Rating & Target price history]

Coway (021240)



Date	131111	131008	130922	130903	130806	130708
Rating	Buy	Buy	Buy	Buy	Buy	Buy
TP	76,000	74,000	74,000	74,000	63,000	63,000
Date	130630	130603	130513	130506	130402	130218
Rating	Buy	Buy	Buy	Buy	Buy	Buy
TP	63,000	63,000	63,000	63,000	63,000	63,000
Date	121226	121026	121007	120819	120809	120725
Rating	Buy	Buy	Buy	Buy	Buy	Buy
TP	51,000	51,000	51,000	51,000	41,000	41,000
Date	120622	120312				
Rating	Buy	Buy				
TP	51,000	51,000				

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.