KDB Daewoo Securities

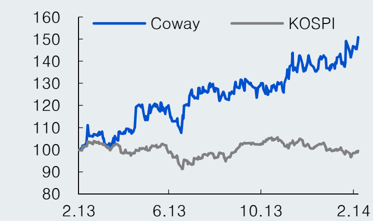
Comsumer Services

Company Report
February 17, 2014

(Maintain)	**Buy**
Target Price (12M, W)	**90,000**
Share Price (02/14/14, W)	70,200
Expected Return	28%

OP (13P, Wbn)	339
Consensus OP (13F, Wbn)	328
EPS Growth (13P, %)	161.4
Market EPS Growth (13F, %)	3.2
P/E (13P, x)	20.8
Market P/E (13F, x)	12.4
KOSPI	1,940.28
Market Cap (Wbn)	5,414
Shares Outstanding (mn)	77
Free Float (%)	65.6
Foreign Ownership (%)	53.2
Beta (12M)	0.84
52-Week Low	46,950
52-Week High	70,200

(%)	**1M**	**6M**	**12M**
Absolute	10.4	23.6	49.5
Relative	10.7	22.5	52.6



Daewoo Securities Co., Ltd.

[Textile/Apparel, Hotel/Leisure]

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COWAY
(021240 KS)

From good to great

4Q13 review: Non-consolidated OP jumps to W88.5bn, beating theconsensus

Coway posted 4Q13 non-consolidated revenue of W482.4bn (+4.9% YoY) and operating profit of W88.5bn (+148.1% YoY). Revenue was in line with our estimate (W480.7bn), but operating profit beat our estimate (W80.8bn) by 9.5% and the consensus (W79bn) by 12%. This marked the third straight quarter in which the company recorded above-consensus operating profit.

The rental asset disposal ratio, a key indicator of asset quality and customer satisfaction, improved to 1.7%, once again breaking the previous record. For the full year, revenue and operating profit grew 7% YoY and 30.9% YoY, respectively, and OP margin sharply improved to 17.3% (vs. 14.7% in 2013).

An unparalleled business portfolio, and strong momentum overseas

For 2014, management guided top-line growth at 7.6% and OP margin at 17.4%. The company plans to place a greater priority on maintaining its high margins than on top-line growth. 2013 was Coway's first year under its new management (MBK Partners), and the company focused on improving cost efficiency and enhancing key indicators, such as product quality and customer satisfaction. In 2014, Coway aims to resume growth of its rental sales by boosting its sales capabilities (via Coway Ladies (CODYs) and home-care doctors) and launching more high-end products. For water purifiers, which have a relatively high penetration in the domestic market, the company plans to diversify its product portfolio and distribution channels. For air purifiers, which still have low penetration (17%), the company is introducing products suited for year-round use. We thus expect to see an increase in rental subscribers, along with higher ARPU driven by a more favorable product mix.

We are also bullish on the company's new businesses and export growth. Overseas operations should continue to grow at above 20%, buoyed by increasing ODM exports and stronger earnings at overseas subsidiaries. We foresee a new growth driver in the mattress rental business, which has shown visible growth since 2H13, supported by a more diversified product lineup and the launch of maintenance services (e.g., air conditioner cleaning).

Maintain Buy and Lift TP by 20% to W90,000

Up until 2012, the biggest risk facing Coway was its governance under the Woongjin Group. But group-related risks have now been fully eliminated, and the company has made significant improvements in its earnings and balance sheet under new management. In our view, the company's core rental business calls for a premium, given its unique R&D strength, strong product quality and robust service network.

We believe Coway has one of the most differentiated business portfolios in the consumer services universe—not only in Korea but in broader Asia as well. We maintain our Buy rating and raise our target price by 20% to W90,000 (from W75,000), as we changed our valuation basis to consolidated earnings, and adjusted up our estimates for the air purifier, mattress, and overseas businesses.

FY (Dec.)	12/10	12/11	12/12	12/13P	12/14F	12/15F
Revenue (Wbn)	2,531	1,824	1,993	2,118	2,272	2,495
OP (Wbn)	282	235	226	339	392	462
OP margin (%)	11.1	12.9	11.3	16.0	17.3	18.5
NP (Wbn)	177	167	94	246	257	310
EPS (W)	2,301	2,166	1,219	3,187	3,329	4,023
ROE (%)	24.6	22.2	12.3	28.2	25.0	26.2
P/E (x)	17.5	16.9	35.7	20.8	21.1	17.4
P/B (x)	3.9	3.3	3.8	4.9	4.6	4.0

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

4Q13 review

4Q13 review: Non-consolidated OP of W88.5bn (+148% YoY), 12% higher than the consensus

Coway posted 4Q13 non-consolidated revenue of W482.4bn (+4.9% YoY) and operating profit of W88.5bn (+148.1% YoY). Revenue was in line with our estimate (W480.7bn), but operating profit beat our estimate (W80.8bn) by 9.5% and the consensus (W79bn) by 12%. This marked the third straight quarter in which the company recorded above-consensus operating profit.

The rental asset disposal ratio, a key indicator of asset quality and customer satisfaction, improved to 1.7%, once again breaking the previous record. For the full year, revenue and operating profit grew 7% and 30.9% YoY, respectively, and OP margin sharply improved to 17.3% (vs. 14.7% in 2013).

On a consolidated basis, Coway's 4Q revenue and operating profit reached W524bn (+0.9% YoY) and W90.5bn (+163.3% YoY). We attribute these strong earnings to the company's disposal of its loss-making Japanese subsidiary and continuously-robust Malaysian and US operations.

Table 1. 4Q13P results (Wbn, %)

	4Q12	3Q13	4Q13P			Growth	
			Actual	KDB Daewoo	Consensus	YoY	QoQ
Revenue	460.1	489.2	482.4	480.7	486.7	4.9	-1.4
Operating profit	35.7	97.0	88.5	80.8	79.0	148.1	-8.8
OP margin	7.8	19.8	18.3	16.8	16.2	136.6	-7.5
Pretax profit	31.7	83.0	72.8	78.9	76.0	129.4	-12.3
Net profit	21.6	62.3	50.9	59.2	58.6	135.8	-18.2

Note: K-IFRS non-consolidated; Source: Company data, KDB Daewoo Securities Research

Table 2. 4Q13P consolidated results (Wbn, %)

	4Q12	3Q13	4Q13P		Growth	
			KDB Daewoo	Consensus	YoY	QoQ
Revenue	519	531	524	512	0.9	-1.2
Operating profit	34	96	91	80	163.3	-6.0
OP margin	6.6	18.1	17.3	15.7	161.3	-4.7
Pretax profit	24	80	91	87	286.2	13.5
Net profit	14	60	69	79	407.8	14.1

Note: K-IFRS consolidated
Source: Company data, KDB Daewoo Securities Research

Table 3. Earnings forecast revisions (Wbn, %)

	Previous		Revised		% chg.		Notes
	13P	14F	13P	14F	13P	14F	
Revenue	1,932	2,053	2,118	2,272	9.6	10.7	- Revised up earnings outlooks for air purifiers, mattresses, and overseas businesses
OP	326	344	339	392	3.7	14.0	
Pretax profit	358	339	328	343	-8.3	1.1	- Reflects investment allowance for Thailand subsidiary
Net profit	262	255	246	257	-6.3	0.9	

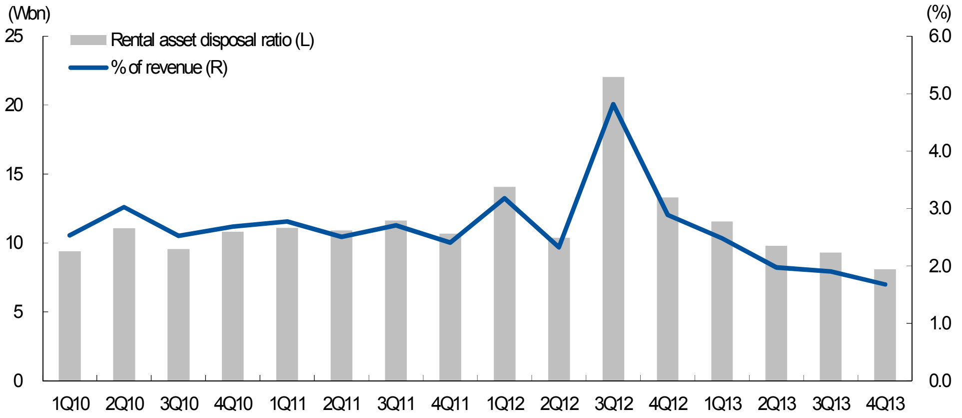
Notes: K-IFRS consolidated; Source: Company data, KDB Daewoo Securities Research

Table 4. Quarterly consolidated earnings (Wbn, %)

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13P
Revenue	478	489	507	519	507	556	531	524
Operating profit	65	64	63	34	70	82	96	91
OP margin	14	13	12	7	14	15	18	17
Net profit	46	-8	43	14	57	60	60	69
Net margin	10	-2	8	3	11	11	11	13
Rental asset disposal losses	14	10	22	13	12	10	9	8
(%, revenue)	3	2	5	3	2	2	2	2

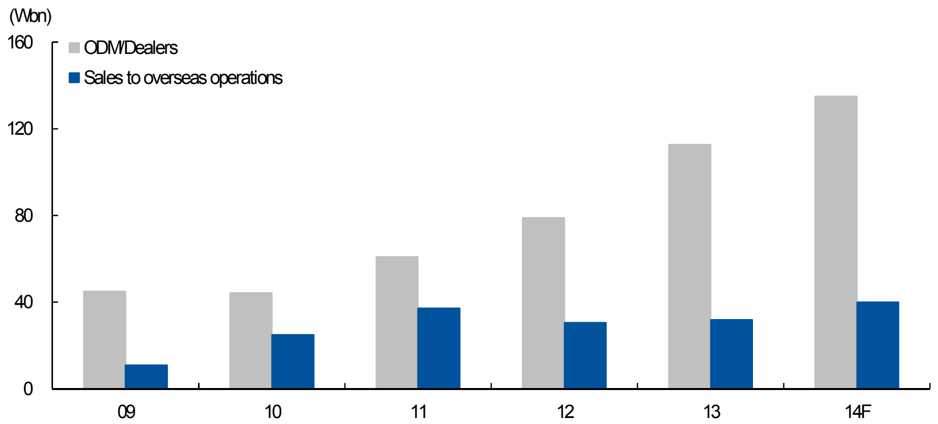
Notes: K-IFRS consolidated; Source: Company data, KDB Daewoo Securities Research

Figure 1. Quarterly rental asset disposal ratio



Source: Company data, KDB Daewoo Securities Research

Figure 2. Annual oversesas earnings and estimates



Source: Company data, KDB Daewoo Securities Research

Valuation

Lift TP by 20% to W90,000 using DCF valuation

We maintain our Buy rating and raise our target price by 20% to W90,000 (from W75,000), as we changed our valuation basis to consolidated earnings, and adjusted up our estimates for the air purifier, mattress, and overseas businesses. We derived our target price using the DCF valuation methodology (Rf: 2.5%; WACC: 5.4%; g: 2.0%).

Our target price of W90,000 corresponds to a 2014 implied P/E of 27.0x, 18.9% higher than the company's four-year average P/E of 22.7x. However, in our view, the company deserves a valuation premium considering that its performances have exceeded market expectations every quarter in 2013. (We note that 2013 was the company's first year of operation outside of the Woongjin Group.) Furthermore, the company's top-line growth potential seems massive in light of its product lineup expansion, as well as growing overseas revenue. And cost-saving efforts are likely to continue.

Table 5. DCF Valuation: Target price raised to W90,000 (Wbn, %, '000 shares)

	14F	15F	16F	17F	18F
EBIT	392	462	471	481	490
- Taxes	99	116	119	121	123
- Capex	269	278	284	289	295
- Chg. in working capital	43	47	48	49	50
+ Depreciation	173	189	193	197	201
+ Amortization	7	7	7	7	7
+ Rental asset disposal losses	37	41	41	41	41
FCFF	198	257	261	266	270
Final year FCFF	270				
Terminal value	8,068				
Terminal growth	2.0%				
NPV of FCFF		1,236			
PV of terminal value		5,880			
Enterprise value		7,115			
Cash & equivalents		201			
Other investments		45			
Interest bearing debt		382			
Current equity value		6,979			
Shares outstanding		77,125			
Target price (W)		**90,000**			
Current price (W)		70,200			
Upside (%)		28.2%			

Source: Company data, KDB Daewoo Securities Research

Purifiers to present another growth opportunity

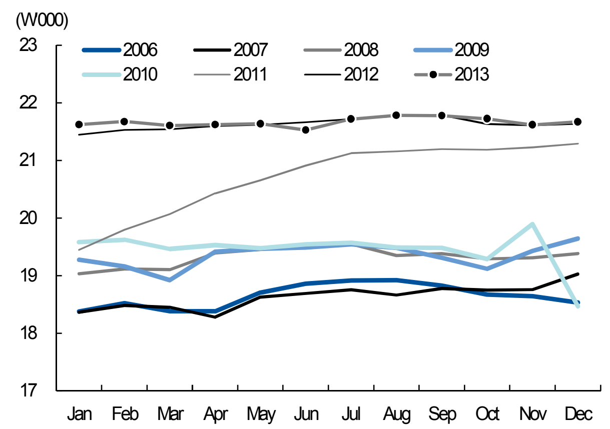
Purifier demand still has room for growth

Coway introduced its water purifiers into the Korea market about 25 years ago (in 1989). As such, their penetration, at slightly below 40%, is higher than the rates of the company's other products. Because water purifiers (rental) account for 59% of the company's total revenue, their net order growth has a significant impact.

Going forward, however, air purifiers are likely to drive the company's earnings. Unlike water purifiers, air purifiers have yet to enjoy structural demand growth since their launch in 2002. An air purifier is not considered an essential good, and contract terminations have been relatively high in the summer and the winter due to seasonality. However, worsening air quality is gradually changing customers' view of air purifiers. In particular, smog and fine dust from China have been problematic for residents of Korea. (Unlike in Korea, where industrialization ended about a decade ago, China's industrialization is progressing full swing.)

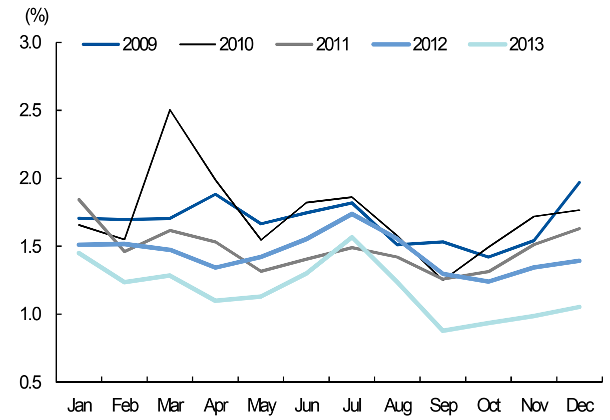
For environmental home appliances such as water and air purifiers, the perception of necessity is a key driver of demand. Necessity is intrinsically determined by environmental factors. In the medium to long term, we expect air purifier demand to surge along with growing environmental awareness.

Figure 3. ARPU rising on growing demand for high-end multifunctional air purifiers



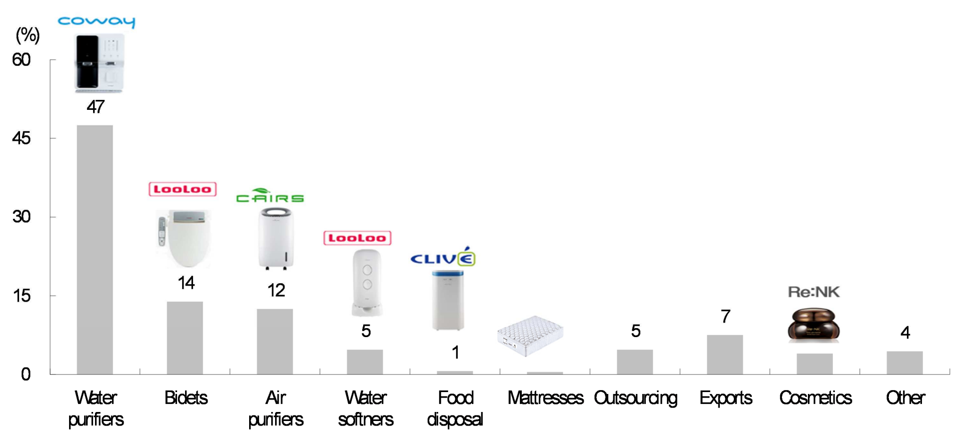
Source: Company data, KDB Daewoo Securities Research

Figure 4. Service cancellations have decreased overall



Source: Company data, KDB Daewoo Securities Research

Figure 5. Revenue breakdown by product



Source: KDB Daewoo Securities Research

Table 6. Revenue breakdown ()

	Products	Contribution (2013)	Growth potential	Momentum driver
Rental + membership	Water purifiers	59	→	- To attract additional customers via product lineup expansion.
	Bidets	17	↗	- Difficulties in maintenance; demand for rentals growing - Growing penetration rate
	Air purifiers	15	↗	- Increasingly considered an essential item due to serious air pollution - Becoming multifunctional; absorbing humidifier demand
	Water softners	6	→	- Increasing number of skin disease patients
	Food disposal	1	→	- Strict restrictions against waste disposal
	Other	2	↗	- Growing demand for mattress rentals; home care areas expanding
Lump-sum payments	Environmental devices	12	→	
	Mattress	2	→	
	Outsourcing	21	↗	- Increasing demand for dehumidifiers due to climate changes
	Exports	34	↑	- Growing ODM orders from overseas buyers; expanding overseas rental operations
	Cosmetics	18	↗	- Growing brand reputation; expanding diet supplement revenue

Source: KDB Daewoo Securities Research

Increasing air pollution to boost demand for environmental appliances

It is premature to expect income growth in China to structurally drive up air purifier demand in light of the fact that the country's per-capita GDP only corresponds to Korea's level in 1999. However, amid a recent wave of dense smog, the Chinese government and citizens have begun to pay more heed to the serious effects of air pollution. The fact that an eight-year-old girl living in the eastern province of Jiangsu was recently diagnosed with lung cancer has further raised concerns over the devastating human toll of the country's air pollution.

Rapid growth in industrial production has given rise to frequent threatening smog level readings. According to the China Meteorological Administration, China experienced 29.9 smoggy days in 2013, 10.3 days more than in the previous year. The 2013 figure was also the highest number since 1961. As China relies significantly on coal for heating (about 70% of heating fuel), smog issues becomes more serious in winter.

In September 2013, China released its Action Plan for Air Pollution Prevention and Control, which targets a minimum 10% reduction of the current air pollution level by 2017. The government-level action plan is unlikely to generate tangible results immediately. As such, we expect demand for environment-related products to increase in the short term.

In China, air purifier penetration rate stands at a mere 0.2%. The Chinese air purifier market more than doubled from RMB2.2bn in 2011 to RMB5bn in 2013, according to *Guangzhou Daily*. However, the Chinese air purifier market is still not large. The mid- to high-end market is dominated by European, Japanese, and US makers, while the low-end market is controlled by local makers. Among high-income earners, air purifiers could potentially see high demand. <Figure 7> shows that mid- to high-end products (priced at RMB3,000 or higher) account for 65% of the country's total demand. Since Coway products are mostly in the mid- to high-end range, we project the company's air purifier exports to expand on the back of rising Chinese demand over the medium to long term. Furthermore, the company may establish a direct presence in the Chinese market over the long term.

Table 7. Air pollution index status of major Chinese cities (ug/m2)

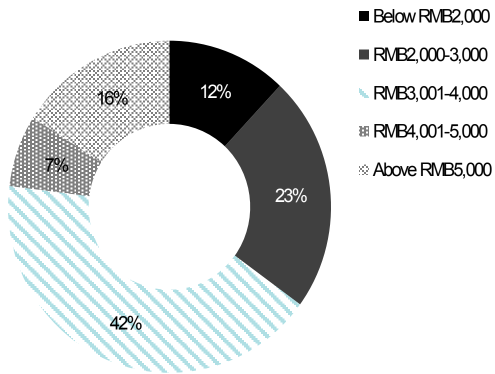
City	Reading	City	Reading
Lanzhou	150	Chengdu	111
Xining	141	Hefei	111
Wulumuqi	140	Shenyang	110
Jinan	123	Taiyuan	106
Beijing	121	Global average	71
Xi'an	113	WHO guidance	25

Source: KOTRA, KDB Daewoo Securities Research

Figure 6. Serious air pollution in China

Source: Baidu

Figure 7. Customers' air purifier preferences by price range (as of 2012)



Source: ZDC

Table 8. Air quality index (AQI) in major Chinese cities

Rank	City	AQI	Rank	City	AQI
1	Beijing	500	15	Wuhan	438
2	Tianjin	500	16	Harbin	390
3	Shijiazhuang	500	17	Changchun	385
4	Shijiazhuang	500	18	Qingdao	379
5	Xíngtái	500	19	Chengdu	368
6	Bǎodìng	500	20	Jinan	345
7	Hengshui	500	21	Wulumuqi	341
8	Lángfángshì	500	22	changsha	337
9	Tangshan	500	23	Nanjing	335
10	Wuxi	500	24	Dalian	333
11	Nántōng	500	25	Shenyang	330
12	Yǎnchéng	500	26	Xi'an	323
13	Zhengzhou	500	27	Hefei	311
14	Guìyáng	500			

Note: AQI above 300 is regarded as serious; seniors and children should refrain from participating in outdoor activities
Source: CNEMC

Table 9. Top 10 air purifier brands in China (2012)

Brand	Country of origin	Price range
Philips	Netherlands	Mid-high
Panasonic	Japan	Mid
Vortek	China	Low-mid
Sharp	Japan	Mid-high
Honeywell	US	High
Daikin	Japan	Mid-high
Broad	China	Low-mid
Midia	China	Low-mid
Gree	China	Low-mid
Airdow	China	Low-mid

Source: Baidu

COWAY (021240 KS/Buy/TP: W90,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
Revenue	**1,993**	**2,118**	**2,272**	**2,495**
Cost of Sales	**678**	**721**	**773**	**849**
Gross Profit	**1,315**	**1,397**	**1,499**	**1,646**
SG&A Expenses	**1,088**	**1,059**	**1,107**	**1,184**
Operating Profit (Adj)	**226**	**339**	**392**	**462**
Operating Profit	**226**	**339**	**392**	**462**
Non-Operating Profit	**-80**	**-11**	**-49**	**-47**
Net Financial Income	-29	-14	-9	-7
Net Gain from Inv in Associates	5	18	0	0
Pretax Profit	146	328	343	415
Income Tax	52	82	86	104
Profit from Continuing Operations	94	246	257	310
Profit from Discontinued Operations	0	0	0	0
Net Profit	94	246	257	310
Controlling Interests	94	246	257	310
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	**99**	**254**	**257**	**310**
Controlling Interests	99	254	257	310
Non-Controlling Interests	0	0	0	0
EBITDA	410	382	572	658
FCF (Free Cash Flow)	140	339	125	181
EBITDA Margin (%)	20.6	18.0	25.2	26.4
Operating Profit Margin (%)	11.3	16.0	17.3	18.5
Net Profit Margin (%)	4.7	11.6	11.3	12.4

Statement of Financial Condition (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
Current Assets	**779**	**697**	**726**	**821**
Cash and Cash Equivalents	152	201	192	242
AR & Other Receivables	247	250	267	293
Inventories	72	66	75	82
Other Current Assets	308	180	192	204
Non-Current Assets	**976**	**991**	**1,047**	**1,094**
Investments in Associates	0	0	0	0
Property, Plant and Equipment	630	655	713	761
Intangible Assets	184	178	172	165
Total Assets	**1,755**	**1,688**	**1,773**	**1,915**
Current Liabilities	**759**	**677**	**637**	**605**
AP & Other Payables	188	181	178	176
Short-Term Financial Liabilities	441	373	343	319
Other Current Liabilities	130	123	116	110
Non-Current Liabilities	**211**	**51**	**43**	**37**
Long-Term Financial Liabilities	154	9	9	9
Other Non-Current Liabilities	57	42	34	28
Total Liabilities	**970**	**728**	**680**	**642**
Controlling Interests	**785**	**960**	**1,093**	**1,273**
Capital Stock	41	41	41	41
Capital Surplus	126	126	126	126
Retained Earnings	701	866	1,000	1,179
Non-Controlling Interests	**0**	**0**	**0**	**0**
Stockholders' Equity	**785**	**960**	**1,093**	**1,273**

Cash Flows (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
Cash Flows from Op Activities	454	604	394	459
Net Profit	94	246	257	310
Non-Cash Income and Expense	420	377	275	307
Depreciation	175	42	173	189
Amortization	8	2	7	7
Others	237	333	95	111
Chg in Working Capital	-24	46	-51	-54
Chg in AR & Other Receivables	-18	40	-18	-26
Chg in Inventories	25	14	-9	-7
Chg in AP & Other Payables	-12	-86	3	5
Income Tax Paid	**-36**	**-65**	**-86**	**-104**
Cash Flows from Inv Activities	-320	-70	-238	-244
Chg in PP&E	-310	-250	-232	-237
Chg in Intangible Assets	-8	0	0	0
Chg in Financial Assets	-2	-42	-8	-10
Others	**0**	**222**	**2**	**3**
Cash Flows from Fin Activities	-76	-495	-165	-166
Chg in Financial Liabilities	47	-212	-30	-25
Chg in Equity	0	0	0	0
Dividends Paid	-78	-78	-124	-130
Others	**-45**	**-205**	**-11**	**-11**
Increase (Decrease) in Cash	54	49	-9	49
Beginning Balance	98	152	201	192
Ending Balance	**152**	**201**	**192**	**242**

Source: Company data, KDB Daewoo Securities Research estimates

Forecasts/Valuations (Summarized)

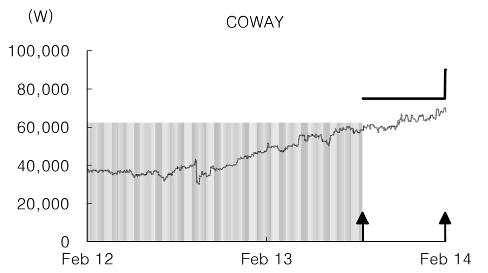
	12/12	12/13F	12/14F	12/15F
P/E (x)	35.7	20.8	21.1	17.4
P/CF (x)	6.5	8.2	10.2	8.8
P/B (x)	3.8	4.9	4.6	4.0
EV/EBITDA (x)	9.3	13.7	9.7	8.3
EPS (W)	1,219	3,187	3,329	4,023
CFPS (W)	6,667	8,081	6,892	8,008
BPS (W)	11,354	13,549	15,275	17,607
DPS (W)	0	1,050	1,660	1,750
Payout ratio (%)	0.0	31.9	48.2	42.0
Dividend Yield (%)	0.0	1.6	2.4	2.5
Revenue Growth (%)	9.3	6.3	7.3	9.8
EBITDA Growth (%)	4.1	-6.8	49.7	15.0
Operating Profit Growth (%)	-3.8	50.0	15.6	17.9
EPS Growth (%)	-43.7	161.4	4.5	20.8
Accounts Receivable Turnover (x)	9.1	8.8	8.8	8.9
Inventory Turnover (x)	22.7	30.9	32.4	31.8
Accounts Payable Turnover (x)	13.8	15.5	16.0	16.2
ROA (%)	5.6	14.3	14.8	16.8
ROE (%)	12.3	28.2	25.0	26.2
ROIC (%)	13.2	22.3	26.3	28.7
Liability to Equity Ratio (%)	123.6	75.8	62.3	50.4
Current Ratio (%)	102.6	102.9	113.9	135.6
Net Debt to Equity Ratio (%)	55.9	14.2	10.1	2.4
Interest Coverage Ratio (x)	7.5	18.2	34.4	43.8

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
COWAY(021240)	02/16/2014	Buy	90,000
	09/01/2013	Buy	75,000
		No Coverage	



Stock Ratings

Buy : Relative performance of 20% or greater
Trading Buy : Relative performance of 10% or greater, but with volatility
Hold : Relative performance of -10% and 10%
Sell : Relative performance of -10%

Industry Ratings

Overweight : Fundamentals are favorable or improving
Neutral : Fundamentals are steady without any material changes
Underweight : Fundamentals are unfavorable or worsening

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.
* Although it is not part of the official ratings at Daewoo Securities, we may call a trading opportunity in case there is a technical or short-term material development.
* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst's estimate of future earnings.
* The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

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