



February 18, 2014

Coway (021240)

Equity Research

Rating downgraded

Weaker sales growth on risk factors

Strong earnings momentum to continue in 1Q14

For 4Q13, Coway posted lower-than-expected sales of W482.4bn (+4.9% YoY) but delivered a positive earnings surprise with OP of W88.5bn (+148.3% YoY) vs. the market consensus of W79.0bn. If excluding one-offs in 4Q12, OP growth would have been 40.4%. Key factors for higher margins were lower SG&A expenses and a substantial drop in rental asset disposal expenses (-35.2% YoY in 2013) on the back of a continued slide in cancellations (2013 cancellation rate was a record-low 0.88%). Strong earnings momentum should continue in 1Q14 in view of a low base last year.

Sales growth should be key; competitions with home shopping channels should be a risk factor

The rental division's slow growth is a potential risk factor. The division represents 70% of total sales. In 2013, Coway posted 193K net adds in rental subscriptions, achieving 123% of its target, but it was mainly attributable to a drop in the cancellation rate. Rental sales (net orders, including lump-sum payments) continued negative growth for three consecutive quarters for the first time since 2009. A shift to positive growth seems unlikely in 1Q14 as well considering a high base last year. Thus, earnings momentum could weaken substantially from 2Q14. Weak rental sales are attributable to 1) higher prices; 2) reduced sales promotions; and 3) fiercer competitions with home shopping companies on the expansion of mid-/low-end rental products. Since 2012, home shopping companies have rapidly expanded rental sales for various products from water purifiers to massage chairs. The problem is, competition rivals are online sales channels. Coway's rental business is based on offline operational networks of about 13K coordinators across the nation. Thus it is hard to expand sales networks aggressively into home shopping or other channels (e.g., discount stores). This problem is not a temporary matter; it should be a structural risk factor.

Downgrade to Neutral; TP lowered to W71,000 from W75,000

We downgrade our rating to Neutral from Buy and cut our TP to W71,000 from W75,000. The stock is trading at 17.8x 12MF P/E, close to its all-time high. The flagship rental division's weaker sales growth and fierce competition with other channels should increase uncertainties about earnings in the mid- to long-term. Robust overseas growth should be positive but still the overseas business represents only a small portion of total sales (7.5% in 2013). We recommend a cautious approach to the stock until the rental division recovers sales growth.

NEUTRAL (↓)

| TP(12M): W71,000 (↓) | CP(Feb. 17): W67,900

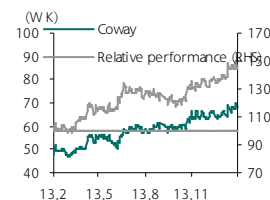
Key Data

KOSPI (pt)	1,946.36
52 week High/Low(W)	70,200/47,150
Market cap(W bn)	5,236.8
Market cap weight (%)	0.46
Shares out ('000)	77,124.8
60-D avg. daily volume('000)	159.0
60-D avg. daily value(W bn)	10.3
DPS (W, 2013)	1,660
DY (% , 2013)	2.60
Foreign ownership (%)	53.20
Major shareholders' stake (%)	
Coway Holdings and 12 persons	30.99
Lazard AM and 33 persons	6.17
Performance	1M 6M 12M
Absolute	2.9 17.7 43.2
Relative	2.8 16.3 45.0

Consensus Data

	2014	2015
Sales (Wbn)	2,081.4	2,230.9
OP (Wbn)	366.0	398.7
NP (Wbn)	273.6	308.9
EPS (W)	3,582	4,040
BPS (W)	14,753	17,588

Stock Price



Financial Data (K-IFRS Separate)

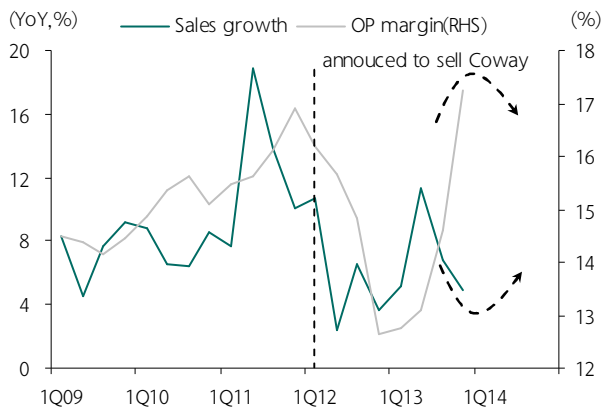
		2011	2012	2013F	2014F	2015F
Sales	Wbn	1,709.9	1,806.8	1,933.7	2,083.0	2,211.8
OP	Wbn	243.3	227.8	334.1	370.2	386.0
PTP	Wbn	225.4	161.5	351.5	348.5	368.9
NP	Wbn	177.1	122.1	224.9	264.0	279.0
EPS	W	2,296	1,583	2,916	3,423	3,617
Chg	%	10.4	(31.1)	84.2	17.4	5.7
PER	X	15.9	27.5	22.8	19.8	18.8
PBR	X	3.3	3.8	4.5	3.7	3.1
EV/EBITDA	X	8.1	9.7	9.4	9.0	8.2
ROE	%	21.4	13.7	24.9	20.5	17.9
BPS	W	11,098	11,583	14,875	18,264	21,852
Net DER	%	56.1	52.2	25.5	9.9	(2.3)



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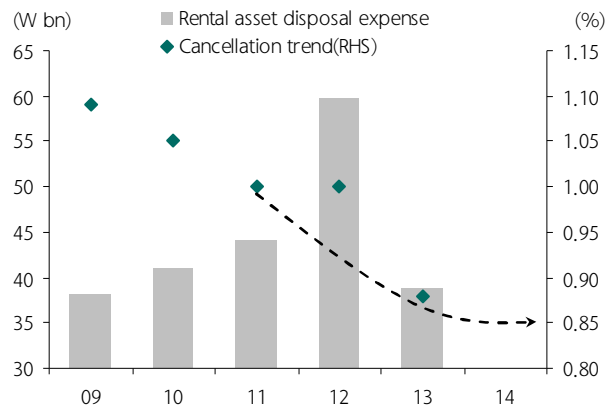
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Figure 1. Additional OPM improvement should be difficult; recovery in sales growth should be key for stock price



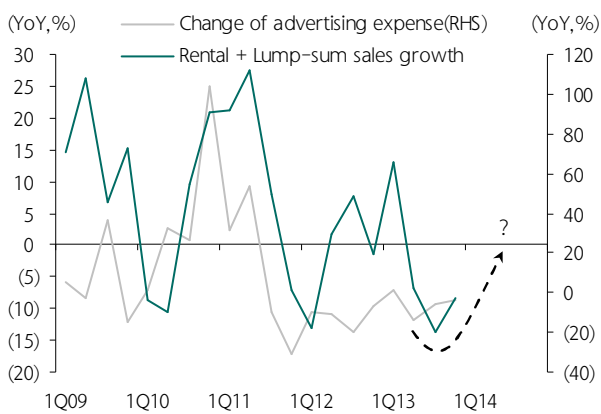
Source: company data, Hana Daetoo Securities

Figure 2. Strong earnings momentum was mainly attributable to lower rental asset disposal expenses thanks to a substantial drop in cancellation rate



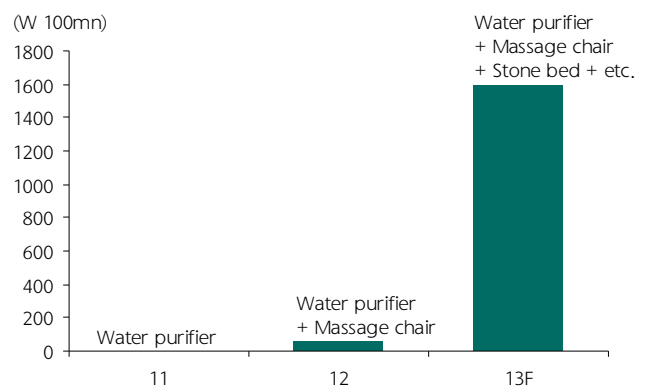
Source: company data, Hana Daetoo Securities

Figure 3. Rental sales dropped for three consecutive quarters, increasing uncertainties about earnings



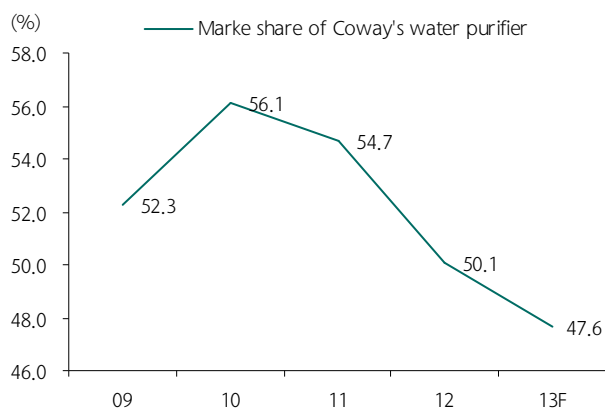
Source: company data, Hana Daetoo Securities

Figure 4. Hyundai Home Shopping: rental sales grew to W160bn in 2013 from W500mn in 2011



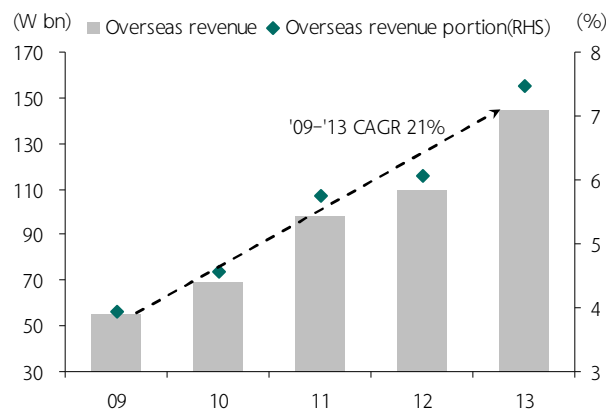
Source: news media, Hana Daetoo Securities

Figure 5. Coway's water purifier market share has continued to drop since 2010



Source: company data, Hana Daetoo Securities

Figure 6. Overseas sales still represent only a small portion of total sales (7.5% in 2013)



Source: company data, Hana Daetoo Securities



Table 1. Coway: quarterly earnings forecasts (K-IFRS separate)

(Wbn)

	1Q13	2Q13	3Q13	4Q13	2013	1Q14F	2Q14F	3Q14F	4Q14F	2014F
Sales	465	497	489	482	1,934	496	535	530	522	2,083
Rental	327	332	335	339	1,333	344	350	356	361	1,411
Membership	43	43	43	44	172	45	46	46	46	183
Lump-sum sales	37	48	35	29	149	34	45	37	30	146
Cosmetics	18	22	17	20	76	21	26	20	23	90
Exports	31	45	38	31	145	42	60	51	41	195
Others	9	8	21	20	58	9	8	21	20	58
OP	69	79	97	89	334	84	87	103	97	370
PTP	115	81	83	73	352	79	79	98	93	348
NP	80	61	62	51	254	59	59	74	69	261
OPM (%)	14.9	16.0	19.8	18.4	17.3	16.9	16.2	19.4	18.5	17.8
RPM (%)	24.7	16.2	17.0	15.1	18.2	15.9	14.7	18.5	17.7	16.7
NPM (%)	17.2	12.2	12.7	10.6	13.1	12.0	11.0	13.9	13.3	12.5

Source: company data, Hana Daetoo Securities

Table 2. Coway: yearly earnings forecasts (K-IFRS separate)

(Wbn)

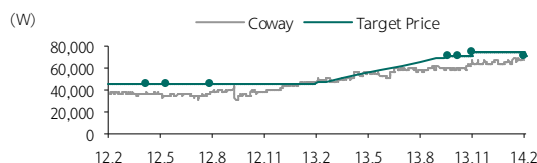
	2012	2013	2014F	2015F	2016F
Sales	1,807	1,934	2,083	2,212	2,308
Rental	1,286	1,333	1,411	1,461	1,486
Membership	161	172	183	188	188
Lump-sum sales	145	149	146	150	154
Cosmetics	67	76	90	106	126
Exports	110	145	195	248	293
Others	38	58	58	59	61
OP	228	334	370	386	400
PTP	161	352	348	369	388
NP	120	254	261	277	291
Adjusted NP (consolidated)	94	281	300	327	291
Fair market cap	1,693	5,057	5,398	5,879	5,237
No. of outstanding shares (K)	77,125	77,125	77,125	77,125	77,125
Fair price (W)	21,948	65,572	69,995	76,224	67,902
Fair P/E(x)	18.0	18.0	18.0	18.0	18.0
EPS(W)	1,219	3,643	3,889	4,235	3,772
OPM (%)	12.6	17.3	17.8	17.5	17.3
Sales (YoY,%)	5.7	7.0	7.7	6.2	4.4
OP (YoY,%)	(6.0)	46.7	10.8	4.3	3.6
NP (YoY,%)	(32.4)	112.0	2.9	5.9	5.1

Source: company data, Hana Daetoo Securities

Rating & Target Price Changes

Coway

Date	Rating	Target Price (W)
14.2.18	Neutral	71,000
13.11.18	BUY	75,000
13.10.23	BUY	71,000
13.10.7	BUY	71,000
12.8.13	BUY	46,000
12.5.29	BUY	46,000
12.4.23	BUY	46,000



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Stock ratings for the next twelve months

- BUY_ Target Price implies at least 15% upside potential
- Neutral_ Target Price implies less than 15% upside or downside potential
- Reduce_ Target Price implies at least 15% downside potential

Sector ratings for the next twelve months

- Overweight_ Sector index implies at least 15% upside potential
- Neutral_ Sector index implies less than 15% upside or downside potential
- Underweight_ Sector index implies at least 15% downside potential

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