

COWAY

(021240 KS)

Standing out from the crowd

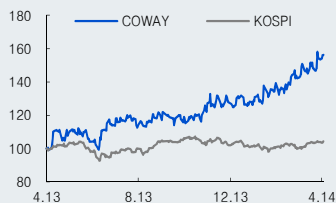
Consumer Services

Earnings Preview
April 21, 2014

(Maintain)	Buy
Target Price (12M, W)	103,000
Share Price (4/18/14, W)	78,700
Expected Return	31%

OP (14F, Wbn)	383
Consensus OP (14F, Wbn)	377
EPS Growth (14F, %)	12.6
Market EPS Growth (14F, %)	28.0
P/E (14F, x)	22.0
Market P/E (14F, x)	10.8
KOSPI	2,004.28
Market Cap (Wbn)	6,070
Shares Outstanding (mn)	77
Free Float (%)	65.3
Foreign Ownership (%)	53.9
Beta (12M)	0.75
52-Week Low	49,950
52-Week High	79,700

(%)	1M	6M	12M
Absolute	9.0	33.4	55.2
Relative	5.5	36.6	47.2



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1Q preview: Revenue of W496.4bn (+6.7% YoY), OP of W85.9bn (+24.1% YoY)

We forecast Coway to post 1Q non-consolidated revenue of W496.4bn (+6.7% YoY), and operating profit of W85.9bn (+24.1% YoY), broadly in line with market expectations. OP margin should come in at 17.3%, slightly beating the consensus of 16.9%, thanks to a more stable SG&A ratio resulting from aggressive cost control efforts since last year.

We believe the rental unit's new accounts fell 0.8% YoY, but increased 8% QoQ. The YoY decline was likely due to high base effects caused by strong pull-in demand in 1Q13 ahead of rental and membership price hikes. In 1Q13, new accounts for water purifiers and bidets, the company's two largest sales contributors, increased 10.3% and 17.8% YoY, respectively.

Air purifier business to benefit from structural demand growth

We believe the air purifier business will become the key driver of Coway's medium- to long-term growth. Although it has been over a decade since the company launched its air purifier line in 2002, air purifiers have not been widely perceived as an essential good by Korean consumers. Traditionally, air purifiers have had relatively high churn rates (1.43% for air purifiers vs. 1.01% overall in 2012) because of highly seasonal demand.

However, worsening air quality caused by smog and fine dust from China appears to be gradually changing customers' view of air purifiers. As a result, the churn rate of air purifiers fell from 1.32% in 1Q13 to a record-low 0.98% in 4Q13.

Water purifiers have benefited from a period of structural demand growth over the past 25 years, and thus have limited room for further growth going forward. We expect water purifiers as a percentage of overall sales to decline from 47.5% in 2013 to 44.5% in 2015. The sales percentage of air purifiers should increase from 12.5% to 13.3% during the same period.

Maintain Buy and lift TP to W103,000

The recent sharp deterioration of China's air quality presents an opportunity for Coway. With China's penetration rate of air purifiers currently at just 0.2%, the country's pollution crisis is strengthening the perception that air purifiers are necessities. Given the strong demand potential among high-income earners, Coway's products (which are mostly in the mid- to high-end range) should see more robust demand as the overall market grows.

We believe Coway deserves a relative premium, given its robust business portfolio, earnings stability, and potential expansion overseas. We maintain our Buy call on Coway and lift our target price by 14.4% to W103,000 from W90,000, as we slightly revised up our earnings estimates for 2016 and beyond and also reduced net debt estimates.

FY (Dec.)	12/11	12/12	12/13	12/14F	12/15F	12/16F
Revenue (Wbn)	1,824	1,993	2,118	2,291	2,496	2,718
OP (Wbn)	235	226	339	383	446	470
OP margin (%)	12.9	11.3	16.0	16.7	17.9	17.3
NP (Wbn)	167	94	245	276	324	345
EPS (W)	2,166	1,219	3,178	3,578	4,205	4,471
ROE (%)	22.2	12.3	28.4	27.1	27.3	25.0
P/E (x)	16.9	35.7	20.9	22.0	18.7	17.6
P/B (x)	3.3	3.8	4.9	5.1	4.4	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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Earnings and forecasts

Table 1. 1Q14 non-consolidated preview (Wbn, %)

	1Q13	4Q13	1Q14		Growth	
			KDB Daewoo	Consensus	YoY	QoQ
Revenue	465	482	496	504	6.7	2.9
Operating profit	69	88	86	85	24.1	-1.9
OP margin (%)	14.9	18.2	17.3	16.9	16.3	-4.7
Pretax profit	115	72	82	90	-29.0	13.7
Net profit	80	50	61	68	-23.6	22.0

Note: Non-consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research

Table 2. 1Q14 consolidated preview (Wbn, %)

	1Q13	4Q13	1Q14		Growth	
			KDB Daewoo	Consensus	YoY	QoQ
Revenue	507	524	539	544	6.1	2.8
Operating profit	70	91	85	87	21.2	-7.2
OP margin (%)	13.7	17.4	15.7	16.0	14.2	-9.7
Pretax profit	75	90	81	86	7.6	-10.3
Net profit	57	68	61	65	5.9	-10.5

Note: Consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research

Table 3. Earnings forecast revisions (Wbn, %)

	Before		After		% chg.		Notes
	14F	15F	14F	15F	14F	15F	
Revenue	2,272	2,495	2,291	2,496	0.8	0.0	
Operating profit	392	462	383	446	-2.1	-3.5	- Upward revision: sales commission rate
Pretax profit	343	415	369	434	7.5	4.6	- Reduction of losses related to affiliates
Net profit	257	310	276	324	7.5	4.5	
EPS (W)	333	402	358	421	7.5	4.5	

Note: Consolidated K-IFRS

Source: KDB Daewoo Securities Research

Table 3. Quarterly earnings forecasts (Wbn, %)

	1Q13	2Q13	3Q13	4Q13	1Q14F	2Q14F	3Q14F	4Q14F
Revenue	507	556	531	524	539	602	581	569
Operating profit	70	82	96	91	85	92	106	100
OP margin (%)	14	15	18	17	16	15	18	18
Net profit (controlling interests)	57	60	60	68	61	66	77	72
Net profit margin (%)	11	11	11	13	11	11	13	13
Rental asset disposal losses	12	10	9	8	9	10	10	9
(% of revenue)	2	2	2	2	2	2	2	2

Source: KDB Daewoo Securities Research

Valuation

Raise TP by 14.4% to W103,000 based on DCF valuation

We maintain our Buy call on Coway and lift our target price by 14.4% to W103,000 using a discounted cash flow (DCF) valuation (risk-free rate of 2.5%, WACC of 5.3%, growth rate assumption of 2.0%). Our 2014-15F earnings estimates remain largely unchanged, but we slightly revised up our earnings forecasts for 2016 and beyond and reduced net debt estimates.

Our target price implies a 2014F P/E of 28.8x, which is 38% higher than the stock's 2013 average multiple. Although our implied P/E may look fairly high in absolute terms, we think Coway's stock warrants a premium given the past four quarters of positive earnings surprises (1Q-4Q13) and the structural demand growth of air purifiers. In addition, we believe the stock should be valued on an absolute basis (rather than on a relative one), considering the fact that there are no companies with a directly comparable business model and Coway's high cash flow visibility.

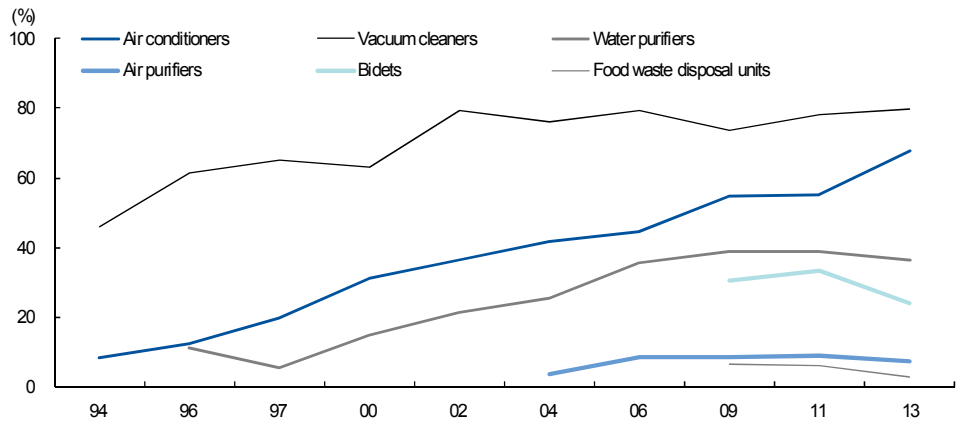
Table 4. DCF valuation

(Wbn, %, '000 shares)

	14F	15F	16F	17F	18F
EBIT	383	446	470	480	489
- Taxes on EBIT	97	112	118	121	123
- Capex	256	267	277	283	288
- Change in net working capital	60	42	42	43	44
+ Depreciation	174	189	205	209	214
+ Amortization	7	7	6	7	7
+ Rental asset disposal losses	38	41	45	46	46
FCFF	190	262	289	295	300
Final year FCFF	280				
Terminal value	8,743				
Terminal growth	2.0%				
NPV of FCFF		1,207			
PV of terminal value		6,763			
Enterprise value		7,970			
Cash & equivalents		267			
Other investments		7			
Interest-bearing debt		336			
Minority interests		0			
Preferred stock		0			
Current equity value		7,908			
Shares outstanding		77,125			
Value per share (W)		103,000			
Current share price (W)		78,700			
Upside (%)		30.9%			

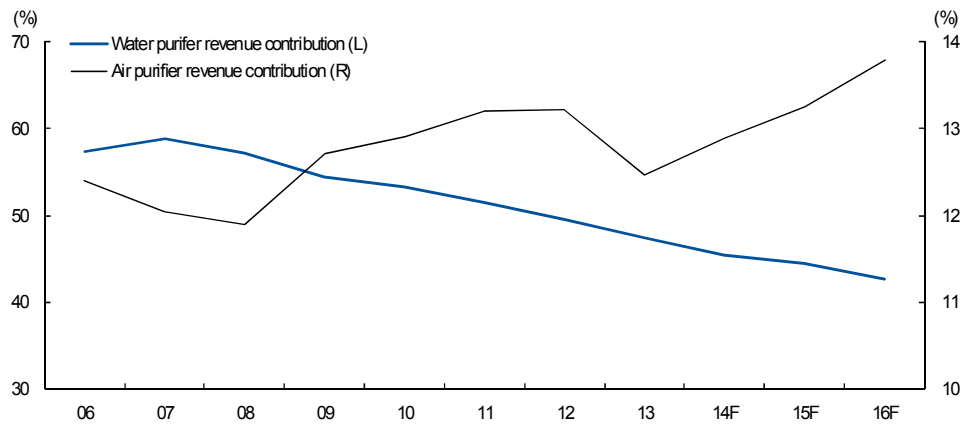
Source: Company data, KDB Daewoo Securities Research

Figure 1. Penetration of major environmental appliances in Korean households



Source: Statistics Korea, KDB Daewoo Securities Research

Figure 2. Trends and forecasts for revenue contributions of water purifiers and air purifiers



Source: Company data, KDB Daewoo Securities Research

COWAY (021240 KS/Buy/TP: W103,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
Revenue	2,118	2,291	2,496	2,718
Cost of Sales	721	787	858	960
Gross Profit	1,397	1,504	1,638	1,758
SG&A Expenses	1,058	1,121	1,192	1,288
Operating Profit (Adj)	339	383	446	470
Operating Profit	339	383	446	470
Non-Operating Profit	-12	-14	-12	-9
Net Financial Income	-14	-6	-4	0
Net Gain from Inv in Associates	18	0	0	0
Pretax Profit	327	369	434	461
Income Tax	82	93	109	116
Profit from Continuing Operations	245	276	324	345
Profit from Discontinued Operations	0	0	0	0
Net Profit	245	276	324	345
Controlling Interests	245	276	324	345
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	244	276	324	345
Controlling Interests	244	276	324	345
Non-Controlling Interests	0	0	0	0
EBITDA	537	564	642	682
FCF (Free Cash Flow)	269	149	217	240
EBITDA Margin (%)	25.4	24.6	25.7	25.1
Operating Profit Margin (%)	16.0	16.7	17.9	17.3
Net Profit Margin (%)	11.6	12.0	13.0	12.7

Statement of Financial Condition (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
Current Assets	691	797	950	1,118
Cash and Cash Equivalents	239	291	406	534
AR & Other Receivables	227	262	285	309
Inventories	66	76	83	90
Other Current Assets	159	168	176	185
Non-Current Assets	976	1,020	1,055	1,080
Investments in Associates	0	0	0	0
Property, Plant and Equipment	638	683	719	746
Intangible Assets	177	171	164	158
Total Assets	1,668	1,817	2,005	2,198
Current Liabilities	677	671	669	666
AP & Other Payables	191	191	195	198
Short-Term Financial Liabilities	335	336	338	338
Other Current Liabilities	151	144	136	130
Non-Current Liabilities	50	52	54	57
Long-Term Financial Liabilities	0	0	0	0
Other Non-Current Liabilities	50	52	54	57
Total Liabilities	727	723	724	723
Controlling Interests	941	1,093	1,282	1,475
Capital Stock	41	41	41	41
Capital Surplus	126	126	126	126
Retained Earnings	868	1,020	1,209	1,402
Non-Controlling Interests	0	0	0	0
Stockholders' Equity	941	1,093	1,282	1,475

Cash Flows (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
Cash Flows from Op Activities	537	405	484	517
Net Profit	245	276	324	345
Non-Cash Income and Expense	374	279	309	328
Depreciation	191	174	189	205
Amortization	8	7	7	6
Others	175	98	113	117
Chg in Working Capital	-41	-58	-40	-40
Chg in AR & Other Receivables	67	-33	-22	-22
Chg in Inventories	19	-10	-7	-7
Chg in AP & Other Payables	-82	0	3	3
Income Tax Paid	-41	-93	-109	-116
Cash Flows from Inv Activities	-76	-219	-224	-226
Chg in PP&E	-258	-218	-226	-232
Chg in Intangible Assets	-2	0	0	0
Chg in Financial Assets	-4	-5	-6	-5
Others	188	4	8	11
Cash Flows from Fin Activities	-373	-134	-146	-163
Chg in Financial Liabilities	-260	1	2	0
Chg in Equity	0	0	0	0
Dividends Paid	-78	-124	-136	-151
Others	-35	-11	-12	-12
Increase (Decrease) in Cash	86	52	115	128
Beginning Balance	152	239	291	406
Ending Balance	239	291	406	534

Source: Company data, KDB Daewoo Securities Research estimates

Forecasts/Valuations (Summarized)

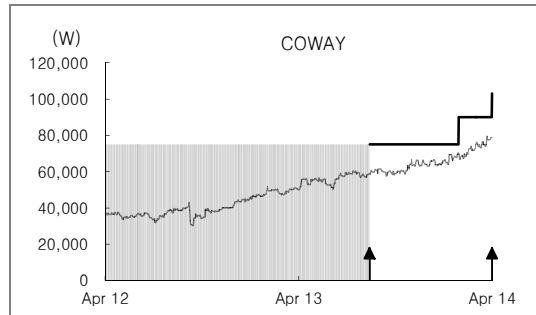
	12/13	12/14F	12/15F	12/16F
P/E (x)	20.9	22.0	18.7	17.6
P/CF (x)	8.3	10.9	9.6	9.0
P/B (x)	4.9	5.1	4.4	3.8
EV/EBITDA (x)	9.7	10.8	9.3	8.6
EPS (W)	3,178	3,578	4,205	4,471
CFPS (W)	8,030	7,201	8,208	8,727
BPS (W)	13,535	15,510	17,953	20,463
DPS (W)	2,710	1,830	2,036	2,240
Payout ratio (%)	82.4	49.3	46.6	48.3
Dividend Yield (%)	4.1	2.3	2.6	2.8
Revenue Growth (%)	6.3	8.2	8.9	8.9
EBITDA Growth (%)	31.0	5.0	13.8	6.2
Operating Profit Growth (%)	50.0	13.0	16.4	5.4
EPS Growth (%)	160.7	12.6	17.5	6.3
Accounts Receivable Turnover (x)	9.5	10.0	9.7	9.7
Inventory Turnover (x)	30.8	32.3	31.5	31.6
Accounts Payable Turnover (x)	17.4	21.4	22.2	22.8
ROA (%)	14.3	15.8	17.0	16.4
ROE (%)	28.4	27.1	27.3	25.0
ROIC (%)	23.0	27.3	29.3	29.2
Liability to Equity Ratio (%)	77.3	66.2	56.5	49.0
Current Ratio (%)	102.2	118.7	142.0	167.8
Net Debt to Equity Ratio (%)	9.5	3.5	-5.9	-13.8
Interest Coverage Ratio (x)	18.2	33.0	38.2	40.2

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
COWAY(021240)	04/21/2014	Buy	103,000
	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 (◆))

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