

# Coway (021240)

Above

In line

Below

12M rating **BUY (Maintain)**  
 12M TP **W94,000** from W94,000  
 Up/downside **+19%**

## Stock Data

KOSPI (Apr 28, pt)	1,969
Stock price (Apr 28, KRW)	79,000
Market cap (USD mn)	5,887
Shares outstanding (mn)	77
52-Week high/low (KRW)	82,900/50,100
6M avg. daily turnover (USD mn)	13.5
Free float / Foreign ownership (%)	65.3/54.0
Major shareholders (%)	
Coway Holdings, Inc. and 12 others	31.0
WooRi Bank	5.8

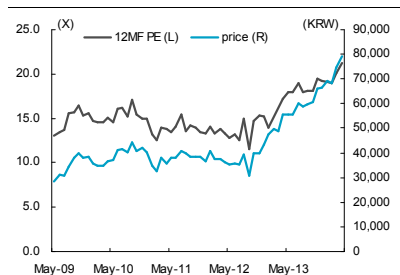
## Valuation

	2013A	2014F	2015F
PE (x)	20.2	20.4	17.8
PB (x)	4.9	5.1	4.4
ROE (%)	28.4	28.3	27.8
EV/EBITDA (x)	9.5	10.4	9.4
EPS (KRW)	3,283	3,877	4,430
BPS (KRW)	13,535	15,539	17,880

## Performance

	1M	6M	12M
Absolute (%)	8.1	33.9	41.8
Relative to KOSPI (%p)	8.7	37.7	40.6

## 12MF PE trend



Source: WISEfn consensus

## Fundamentals improve, growth outlook intact

### What's new: Solid earnings despite difficult conditions

Coway posted 1Q14 separate sales of W494.8bn, up 6% YoY, and OP of 89.8bn, up 30% YoY, in line with our estimates and slightly above the consensus. OPM climbed 3.2%p to 18.1%. Consolidated sales grew 5% YoY to W535bn, and OP 30% YoY to W90.3bn. Rental subscribers climbed 1.6% YoY and ARPU 2.1% YoY. Rental sales decreased 0.4% YoY, but rose 8% QoQ, and continues to rebound since bottoming in 3Q13. Cancellation rate increased slightly to 2.7% QoQ, but this is still positive as it is below the 3% recorded in 1Q13.

### Pros: High earnings visibility and better margins, growth potential confirmed

We are bullish on the high earnings visibility of the rental business and better margins. Profitability firmed in 1Q14, on: 1) higher ARPU, 2) less rental disposal losses on a low cancellation rate (W9.5bn, -18% YoY), 3) less sales commission on a decline in lump-sum payment product sales, and 4) tight SG&A cost controls. Meanwhile, growth potential was also confirmed as cosmetics surged 17% YoY and exports 44% YoY, while environmental home appliances improved only 4% YoY. It is also positive that the Malaysian and US subsidiaries posted favorable sales, and the cosmetics division continued to grow following favorable home shopping sales.

### Cons: Low net subscriber growth, subscriber expansion needs to be confirmed

Net subscriber growth in 2013 was the lowest level since 2009, but Coway plans to grow by reviving net subscriber growth. As such, 1) growing sales, and 2) a low cancellation rate are essential. Coway's rental sales growth target is 7% YoY to 1.25mn and net subscriber growth target 0.25mn. While the low net subscriber growth compared to the low cancellation rate is partially due to free trial memberships expiring, we believe subscriptions for water purifiers and other core products were fueled by renewal demand from existing members rather than new subscribers. Low net subscriber growth was offset by increasing ARPU and the growth of non-core businesses. We expect net subscriber growth will pick up from 2Q14 on reinforced new products and a complex air purifier.

### Conclusion: Positive on earnings visibility and expansion, Maintain BUY with TP of W94,000

We maintain BUY with a TP of W94,000 (23x 12MF PE, 10% premium to historical peak). We are favorable on steadily growing demand for environmental home

(W bn, %, %p)

(Separate)	1Q14P				Change		2014F	
	KIS est.	Actual	Diff.	Consensus	QoQ	YoY	KIS	Consensus
Sales	493	495	0.3	498	2.6	6.4	2,102	2,072
OP	89	90	1.3	85	2.5	29.7	382	366
OP margin	18.0	18.1	0.2	17	(1.7)	3.3	18.2	17.7
EBT	89	88	(1.3)	84	22.3	(23.6)	379	367
NP	68	66	(2.2)	64	31.7	(17.6)	287	274

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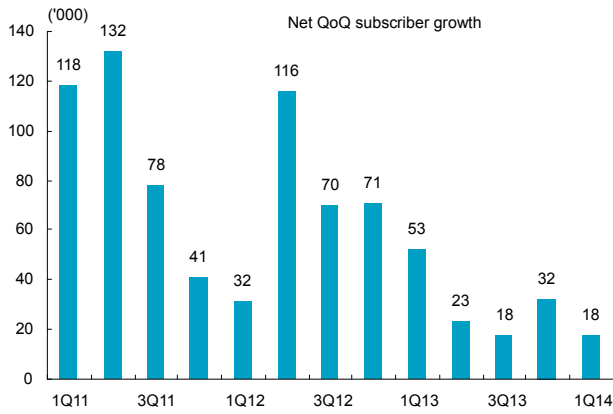
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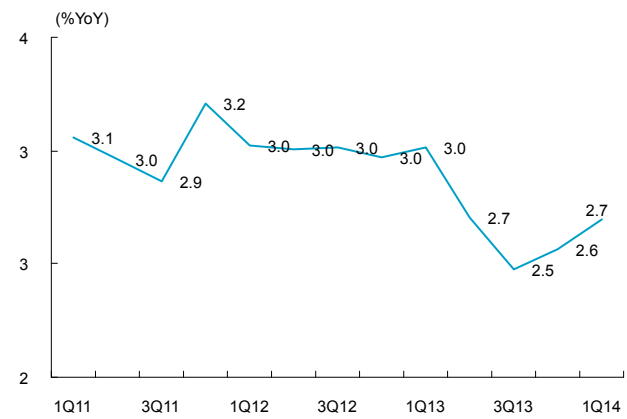
appliances, solid cash flows at the rental business and expansion strategy of the domestic and overseas markets. We believe the recent share re-rating will continue on consistent efforts to grow shareholder value, such as a 2014 dividend yield of 2.3%. Going forward, subscriber growth will be key.

**Figure 1. Low net subscriber growth as free membership trials expire**



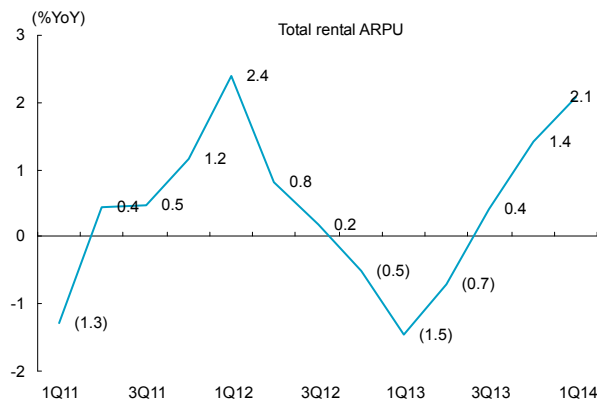
Source: Coway, Korea Investment securities & Investment

**Figure 2. Low cancellation rate compared to 1Q13, slightly up QoQ**



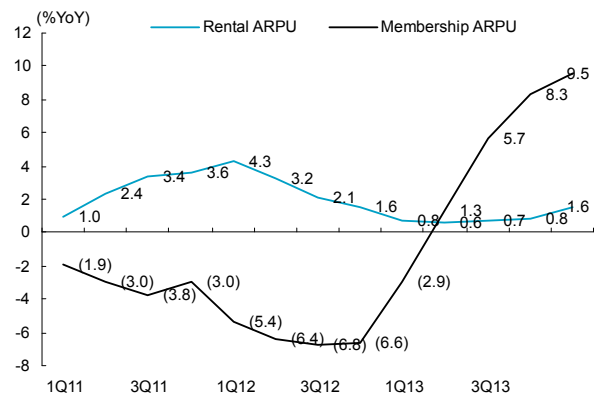
Source: Coway, Korea Investment securities & Investment

**Figure 3. Increasing rental ARPU**



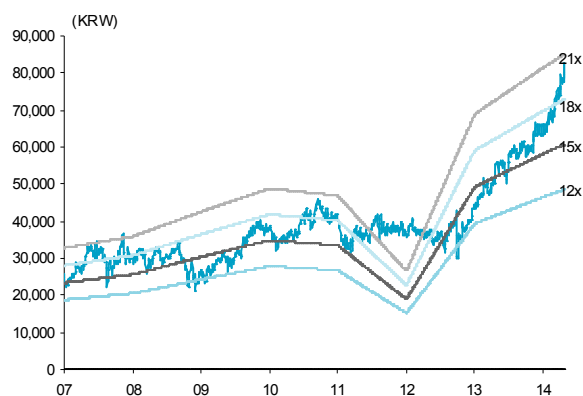
Source: Coway, Korea Investment securities & Investment

**Figure 4. Sharply increasing membership ARPU. Ending of service account and ASP markup**



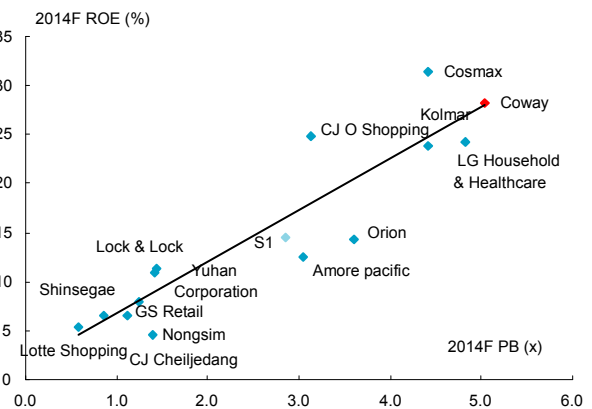
Source: Coway, Korea Investment securities & Investment

**Figure 5. Continuing re-rating**



Source: Quantwise, Korea Investment securities & Investment

**Figure 6. Less valuation merit compared to the past**



Source: Quantwise, Korea Investment securities & Investment

Table 1. 1Q14 earnings

(W bn, KRW, '000 subs, %YoY, %)

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14
Total no. of accounts	5,201	5,333	5,411	5,452	5,484	5,600	5,670	5,741	5,793	5,816	5,834	5,866	5,884
Increase in total account (QoQ)	118	132	78	41	32	116	70	71	53	23	18	32	18
%YoY	8.4	9.6	9.7	7.3	5.4	5.0	4.8	5.3	5.6	3.9	2.9	2.2	1.6
No. of rental account ('000, end of Q)	4,234	4,321	4,377	4,450	4,480	4,518	4,551	4,607	4,658	4,717	4,746	4,800	4,824
Increase in rental account (QoQ)	89	87	55	73	30	38	34	56	50	59	30	54	24
No. of membership account ('000, end of Q)	967	1,011	1,034	1,002	1,004	1,082	1,118	1,133	1,135	1,100	1,088	1,066	1,058
Increase in membership accounts (QoQ)	29	44	23	(32)	2	78	36	15	2	(36)	(12)	(21)	(6)
No. of new rental sales ('000 units)	330	342	288	313	285	331	294	310	318	298	257	292	317
No. of new rental sales (%YoY)	21.3	24.8	4.2	(9.4)	(13.6)	(3.2)	2.0	(1.2)	11.7	(9.9)	(12.3)	(5.6)	(0.4)
Cancel rate (%)	3.1	3.0	2.9	3.2	3.0	3.0	3.0	3.0	3.0	2.7	2.5	2.6	2.7
Rental ARPU (Won)	21,206	21,493	21,511	21,706	21,715	21,667	21,550	21,595	21,398	21,516	21,636	21,900	21,843
Rental ARPU (%YoY)	(1.3)	0.4	0.5	1.2	2.4	0.8	0.2	(0.5)	(1.5)	(0.7)	0.4	1.4	2.1
Membership ARPU (KRW)	22,218	22,586	22,845	22,993	23,164	23,319	23,325	23,357	23,347	23,468	23,495	23,547	23,716.1
Membership ARPU (%YoY)	1.0	2.4	3.4	3.6	4.3	3.2	2.1	1.6	0.8	0.6	0.7	0.8	1.6
Sales	13,686	13,457	13,347	13,348	12,948	12,594	12,446	12,467	12,573	12,753	13,159	13,498	13,772.5
%YoY	(1.9)	(3.0)	(3.8)	(3.0)	(5.4)	(6.4)	(6.8)	(6.6)	(2.9)	1.3	5.7	8.3	9.5
Rental	400	436	430	444	442	446	458	460	465	497	489	482	494
%YoY	9.4	19.3	15.6	11.3	10.6	2.4	6.5	3.6	5.2	11.3	6.8	4.9	6.1
Rental	327	340	347	354	356	360	364	370	370	375	378	384	385
%YoY	6.5	9.5	10.2	9.7	8.9	6.1	5.1	4.5	3.9	4.0	3.8	4.0	4.0
Membership	288	300	306	313	317	321	323	327	327	332	335	339	342
%YoY	6.0	9.5	10.3	10.0	10.1	7.1	5.7	4.6	3.2	3.5	3.6	3.6	4.6
Lump sum payment	39	40	41	41	39	39	41	42	43	43	43	44	44
%YoY	9.8	9.0	9.3	7.3	(0.4)	(1.3)	0.3	3.6	9.8	8.5	5.1	3.2	2.6
Cosmetics	32	39	41	32	33	41	39	32	37	48	35	29	28
%YoY	19.2	57.0	67.3	1.6	2.7	4.5	(4.6)	1.6	11.9	18.0	(9.4)	(9.2)	(24.6)
Export	17	18	18	15	17	16	17	17	18	22	17	20	21
%YoY	NA	NA	878.4	(29.1)	(3.3)	(8.8)	(1.8)	9.7	6.6	35.3	(4.2)	17.9	17.1
Others	18	23	25	32	30	21	20	31	32	45	38	31	45
%YoY	5.8	33.1	60.1	66.5	63.9	(8.0)	(18.8)	(5.6)	5.0	111.1	90.7	0.4	43.5
Total no. of accounts	5	17	0	11	7	8	17	11	9	8	21	20	15
Increase in total account (QoQ)	(63.5)	26.2	(97.7)	167.0	28.9	(50.6)	4711.7	(0.9)	36.7	(5.0)	21.1	83.9	62.6
Gross profit	274	295	295	294	297	304	306	294	311	329	319	323	326
GP margin (%)	68.6	67.6	68.7	66.1	67.1	68.2	66.9	63.9	66.8	66.2	65.3	67.0	66.0
OP	70	73	73	28	64	65	63	36	69	79	97	88	90
%YoY	(12.9)	(15.0)	1.3	(59.6)	(7.8)	(10.3)	(14.0)	27.3	7.9	21.9	54.2	145.7	29.7
OP margin (%)	17.4	16.7	17.0	6.3	14.5	14.6	13.7	7.7	14.9	16.0	19.8	18.2	18.2
EBT	50	55	65	55	56	56	18	32	115	81	83	72	88
%YoY	(22.1)	(27.5)	22.4	10.9	10.3	2.5	(72.6)	(42.5)	106.7	43.1	369.2	126.3	(23.6)
NP	39	42	49	47	41	44	13	22	80	61	62	50	66
%YoY	(25)	(29)	37	29	6	5	(74)	(54)	95	38	382	132	(18)

Source: Coway, Korea Investment securities &amp; Investment

**Balance sheet**

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Current assets	779	691	764	879	984
Cash & cash equivalent	152	239	264	332	389
Accounts & other receivables	262	250	276	301	328
Inventory	72	66	73	79	86
Non-current assets	976	976	1,031	1,084	1,139
Investment assets	54	55	61	66	72
Tangible assets	630	638	657	676	695
Intangible assets	184	177	195	213	232
Total assets	1,755	1,668	1,795	1,963	2,123
Current liabilities	759	677	644	626	581
Accounts & other payables	236	224	248	271	294
ST debt & bond	330	182	132	82	32
Current portion of LT debt	110	146	146	146	146
Non-current liabilities	211	50	55	61	66
Debentures	118	0	0	0	0
LT debt & financial liabilities	36	0	0	0	0
Total liabilities	970	727	699	687	647
Controlling interest	785	941	1,095	1,276	1,477
Capital stock	41	41	41	41	41
Capital surplus	126	126	126	126	126
Capital adjustments	(85)	(94)	(94)	(94)	(94)
Retained earnings	701	868	1,023	1,203	1,404
Minority interest	0	0	0	0	0
Shareholders' equity	785	941	1,095	1,276	1,477

**Cash flow**

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
C/F from operating	454	537	454	512	518
Net profit	94	245	288	329	364
Depreciation	175	191	183	183	183
Amortization	8	8	8	9	10
Net incr. in W/C	(24)	(41)	(27)	(11)	(41)
Others	201	134	2	2	2
C/F from investing	(319)	(76)	(245)	(245)	(247)
CAPEX	(314)	(268)	(202)	(202)	(202)
Decr. in fixed assets	4	10	0	0	0
Incr. in investment	(3)	180	(6)	(6)	(6)
Net incr. in intangible assets	(8)	(2)	(27)	(27)	(29)
Others	2	4	(10)	(10)	(10)
C/F from financing	(76)	(373)	(184)	(199)	(213)
Incr. in equity	12	5	0	0	0
Incr. in debts	20	(262)	(50)	(50)	(50)
Dividends	(78)	(78)	(202)	(134)	(149)
Others	(30)	(38)	68	(15)	(14)
C/F from others	(5)	(1)	0	0	0
Increase in cash	54	86	25	69	57

Note: Based on K-IFRS (consolidated)

**Income statement**

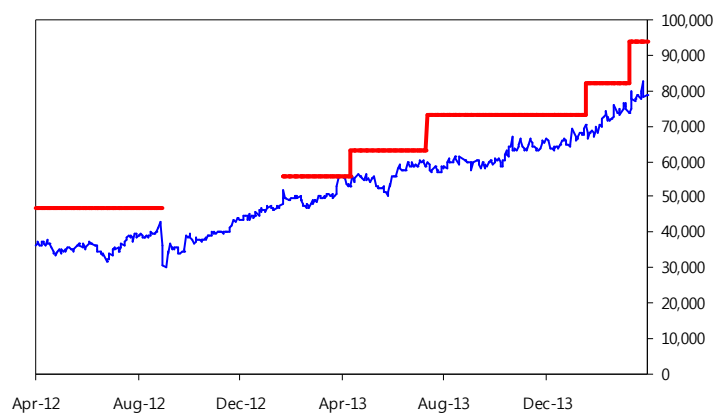
FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Sales	1,993	2,118	2,340	2,556	2,782
COGS	678	721	796	859	935
Gross profit	1,315	1,397	1,545	1,697	1,847
SG&A expense	1,088	1,058	1,160	1,262	1,369
Operating profit	226	339	384	436	479
Financial income	2	4	6	8	9
Interest income	2	4	6	8	9
Financial expense	30	19	9	8	6
Interest expense	30	19	9	8	6
Other non-operating profit	(58)	(15)	(1)	(1)	(1)
Gains (Losses) in associates, subsidiaries and JV	5	18	0	0	0
Earnings before tax	146	327	380	434	480
Income taxes	52	82	92	105	116
Net profit	94	245	288	329	364
Net profit of controlling interest	94	245	288	329	364
Other comprehensive profit	5	(1)	0	0	0
Total comprehensive profit	99	244	288	329	364
Total comprehensive profit of controlling interest	99	244	288	329	364
EBITDA	410	537	576	628	672

**Key financial data**

FY-ending Dec.	2012A	2013A	2014F	2015F	2016F
per share data (KRW)					
EPS	1,267	3,283	3,877	4,430	4,899
BPS	11,354	13,535	15,539	17,880	20,481
DPS	0	2,710	1,800	2,000	2,200
Growth (%)					
Sales growth	9.2	6.3	10.5	9.2	8.8
OP growth	(3.7)	49.9	13.3	13.4	9.9
NP growth	(43.7)	160.6	17.6	14.2	10.6
EPS growth	(43.3)	159.1	18.1	14.3	10.6
EBITDA growth	3.9	31.1	7.2	9.0	7.0
Profitability (%)					
OP margin	11.3	16.0	16.4	17.0	17.2
NP margin	4.7	11.6	12.3	12.9	13.1
EBITDA margin	20.6	25.4	24.6	24.6	24.1
ROA	5.6	14.3	16.7	17.5	17.8
ROE	12.3	28.4	28.3	27.8	26.4
Dividend yield	0.0	4.1	2.3	2.6	2.8
Stability					
Net debt (W bn)	439	90	14	(105)	(213)
Debt/equity ratio (%)	75.7	35.6	26.0	18.4	12.5
Valuation (X)					
PE	34.4	20.2	20.4	17.8	16.1
PB	3.8	4.9	5.1	4.4	3.9
PS	1.7	2.4	2.6	2.4	2.2
EV/EBITDA	9.0	9.5	10.4	9.4	8.6

**Changes to recommendation and price target**

Company (Code)	Date	Recommendation	Price target
Coway (021240)	09-28-12	Hold	-
	02-18-13	BUY	W56,000
	05-11-13	BUY	W63,000
	08-09-13	BUY	W73,000
	02-16-14	BUY	W82,000
	04-08-14	BUY	W94,000



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- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of -15% or less
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- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

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