

# Coway

(021240 KS)

## Robust earnings to continue, validating premium

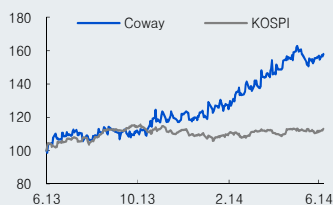
### Consumer Services

Earnings Preview  
July 3, 2014

(Maintain)	<b>Buy</b>
Target Price (12M, W)	<b>103,000</b>
Share Price (07/02/14, W)	84,900
Expected Return	21%

OP (14F, Wbn)	383
Consensus OP (14F, Wbn)	389
EPS Growth (14F, %)	13.4
Market EPS Growth (14F, %)	20.2
P/E (14F, x)	23.6
Market P/E (14F, x)	11.4
KOSPI	2,015.28
Market Cap (Wbn)	6,548
Shares Outstanding (mn)	77
Free Float (%)	65.4
Foreign Ownership (%)	53.4
Beta (12M)	0.39
52-Week Low	55,800
52-Week High	87,500

(%)	1M	6M	12M
Absolute	-1.7	29.0	51.3
Relative	-2.4	25.9	39.3



Daewoo Securities Co., Ltd.

[Textile/Apparel, Hotel/Leisure]

Regina Hahm  
+822-768-4172  
regina.hahm@dwsec.com

### 2Q preview: Revenue of W532.1bn (+7.1% YoY), OP of W91.3bn (+15.0% YoY)

We expect Coway to post 2Q non-consolidated revenue of W532.1bn (+7.1% YoY, +7.5% QoQ) and operating profit of W91.3bn (+15.0% YoY, +1.7% QoQ; OP margin of 17.2%). The company should record positive YoY and QoQ growth in both revenue and operating profit, continuing its robust track record.

Our revenue forecast is slightly above consensus, but our OP margin estimate (17.2%) is lower than consensus (17.7%), reflecting higher costs (labor and commissions) associated with the company's growth-oriented strategy. Meanwhile, new rental accounts, a barometer of the rental business's growth, are likely to have increased 5% YoY in 2Q, following several quarters of YoY negative growth since 2Q13.

### Continuing growth in both price and volume

After improving asset quality and SG&A efficiency, Coway has been shifting its focus to driving top-line growth this year by acquiring new customers, improving product mix, and expanding distribution channels. We expect new rental accounts to grow 4.9% YoY in 2014 as the company rapidly moves into new distribution channels (large discount stores, electronics retailers, and home shopping channels).

Coway's earnings growth was long-driven by demand for higher-end water purifier models and the resulting ARPU growth. Since 2H13, there has also been a marked increase in demand for premium models of the company's non-core products, such as air purifiers and mattresses. Subsequently, rental ARPU growth, which stood at a meager 0.4% YoY in 2013, surged to 7.7% YoY in 1Q14. Such acceleration should continue throughout the year, backed by a combination of higher ASP and improved product mix.

### Maintain Buy and TP of W103,000; Relative and absolute premium justifiable

Coway's high valuation has been a topic of much debate, but we continue to believe the stock should not be measured with simple valuation metrics. First, as there are no companies with a directly comparable business model, a relative valuation could be misleading. Also, we think the company's efficient supply chain, from product development to production and rental sales, is a unique strength that supports strong growth potential and high profitability.

At a time when many consumer stocks are clouded by challenging earnings outlooks, we believe Coway's robust profitability and cash flow support the case for a valuation premium on both a relative and absolute basis. We reiterate Buy on Coway with a target price of W103,000.

FY (Dec.)	12/11	12/12	12/13	12/14F	12/15F	12/16F
Revenue (Wbn)	1,824	1,993	2,118	2,271	2,458	2,651
OP (Wbn)	235	226	339	383	431	466
OP margin (%)	12.9	11.3	16.0	16.9	17.5	17.6
NP (Wbn)	167	94	245	278	314	347
EPS (W)	2,166	1,219	3,178	3,605	4,076	4,503
ROE (%)	22.2	12.3	28.4	27.5	26.8	25.5
P/E (x)	16.9	35.7	20.9	23.6	20.8	18.9
P/B (x)	3.3	3.8	4.9	5.5	4.8	4.2

Note: 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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## 2Q14F preview

**Table 1. 2Q14F non-consolidated earnings forecast** (Wbn, %)

	2Q13	1Q14	2Q14F		Growth	
			KDB Daewoo	Consensus	YoY	QoQ
Revenue	497	495	532	531	7.1	7.5
Operating profit	79	90	91	94	15.0	1.7
OP margin (%)	16.0	18.1	17.2	17.7		
Pretax profit	81	88	89	92	10.6	1.6
Net profit	61	66	67	69	10.5	1.3

Notes: Based on non-consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research

**Table 2. 2Q14F consolidated earnings forecast** (Wbn, %)

	2Q13	1Q14	2Q14F		Growth	
			KDB Daewoo	Consensus	YoY	QoQ
Revenue	556	535	592	598	6.3	10.6
Operating profit	82	90	96	97	16.8	6.0
OP margin (%)	14.7	16.9	16.2	16.2		
Pretax profit	81	88	93	95	14.4	4.8
Net profit	60	66	69	71	15.7	4.5

Notes: Based on consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research

**Table 3. Earnings forecast revisions** (Wbn, %)

	Previous		Revised		% chg.		Notes
	14F	15F	14F	15F	14F	15F	
Revenue	2,285	2,487	2,271	2,458	-0.6	-1.1	- Revised consolidated earnings
Operating profit	384	438	383	431	-0.4	-1.5	
Pretax profit	363	418	372	421	2.5	0.6	- Upward revision of non-operating profit
Net profit	271	313	278	314	2.5	0.5	
EPS (W)	352	405	360	408	2.5	0.5	

Notes: Based on consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research

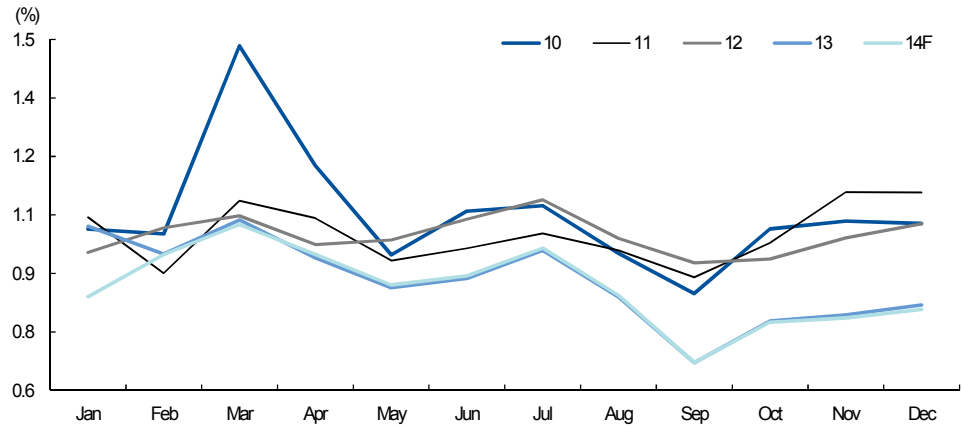
**Table 4. Consolidated quarterly earnings forecast** (Wbn, %)

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14F	3Q14F	4Q14F
Revenue	507	556	531	524	535	592	573	571
Operating profit	70	82	96	91	90	96	102	95
OP margin (%)	13.7	14.7	18.1	17.4	16.9	16.2	17.7	16.6
Net profit	57	60	60	68	66	69	74	69
Net margin (%)	11	11	11	13	12	12	13	12
Impairment losses	12	10	9	8	10	10	10	10
(% of parent rental revenue)	4	3	3	2	3	3	3	3

Notes: Based on consolidated K-IFRS

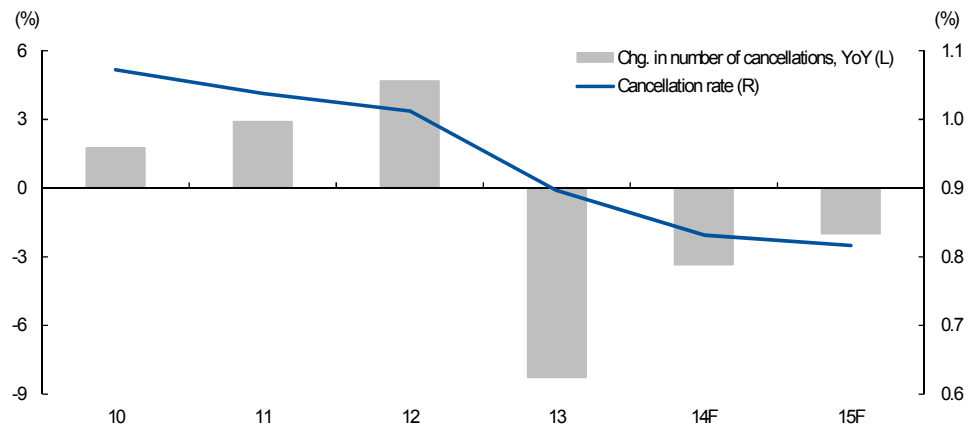
Source: Company data, KDB Daewoo Securities Research

**Figure 1. Decreasing trend in rental cancellation rate**



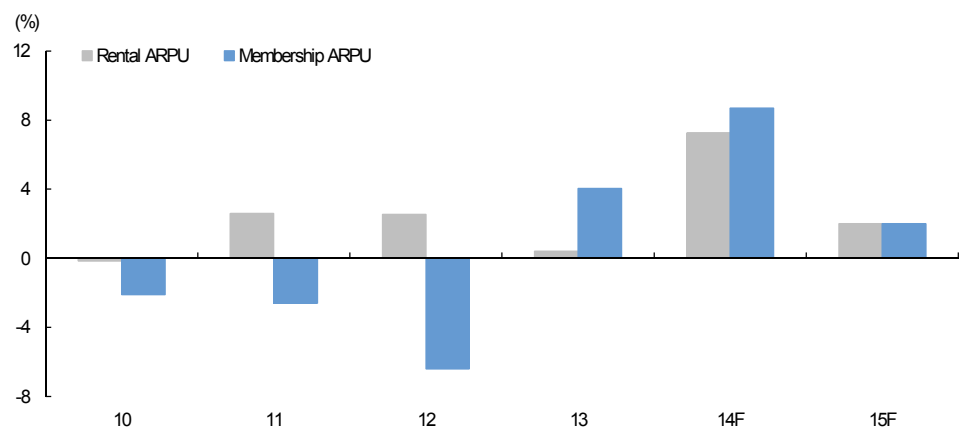
Source: Company data, KDB Daewoo Securities Research

**Figure 2. Annual change in cancelled accounts and cancellation rates have improved since 2013**



Source: Company data, KDB Daewoo Securities Research

**Figure 3. Rental and membership ARPU to increase on improved product mix and higher ASP**



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
<b>Revenue</b>	<b>2,118</b>	<b>2,271</b>	<b>2,458</b>	<b>2,651</b>
<b>Cost of Sales</b>	<b>721</b>	<b>796</b>	<b>884</b>	<b>965</b>
<b>Gross Profit</b>	<b>1,397</b>	<b>1,475</b>	<b>1,574</b>	<b>1,686</b>
<b>SG&amp;A Expenses</b>	<b>1,058</b>	<b>1,093</b>	<b>1,142</b>	<b>1,220</b>
<b>Operating Profit (Adj)</b>	<b>339</b>	<b>383</b>	<b>431</b>	<b>466</b>
<b>Operating Profit</b>	<b>339</b>	<b>383</b>	<b>431</b>	<b>466</b>
<b>Non-Operating Profit</b>	<b>-12</b>	<b>-11</b>	<b>-10</b>	<b>-1</b>
Net Financial Income	-14	-7	-6	-5
Net Gain from Inv in Associates	18	0	0	0
Pretax Profit	327	372	421	465
Income Tax	82	94	106	117
Profit from Continuing Operations	245	278	314	347
Profit from Discontinued Operations	0	0	0	0
<b>Net Profit</b>	<b>245</b>	<b>278</b>	<b>314</b>	<b>347</b>
Controlling Interests	245	278	314	347
Non-Controlling Interests	0	0	0	0
<b>Total Comprehensive Profit</b>	<b>244</b>	<b>273</b>	<b>314</b>	<b>347</b>
Controlling Interests	244	273	314	347
Non-Controlling Interests	0	0	0	0
EBITDA	537	519	623	669
FCF (Free Cash Flow)	269	197	176	222
EBITDA Margin (%)	25.4	22.9	25.3	25.2
Operating Profit Margin (%)	16.0	16.9	17.5	17.6
Net Profit Margin (%)	11.6	12.2	12.8	13.1

## Statement of Financial Condition (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
<b>Current Assets</b>	<b>691</b>	<b>889</b>	<b>997</b>	<b>1,138</b>
Cash and Cash Equivalents	239	387	460	569
AR & Other Receivables	227	262	283	301
Inventories	66	72	78	83
Other Current Assets	159	168	176	185
<b>Non-Current Assets</b>	<b>976</b>	<b>1,009</b>	<b>1,045</b>	<b>1,076</b>
Investments in Associates	0	0	0	0
Property, Plant and Equipment	638	665	703	736
Intangible Assets	177	174	167	161
<b>Total Assets</b>	<b>1,668</b>	<b>1,897</b>	<b>2,042</b>	<b>2,214</b>
<b>Current Liabilities</b>	<b>677</b>	<b>751</b>	<b>712</b>	<b>683</b>
AP & Other Payables	191	199	214	228
Short-Term Financial Liabilities	335	276	276	276
Other Current Liabilities	151	276	222	179
<b>Non-Current Liabilities</b>	<b>50</b>	<b>62</b>	<b>67</b>	<b>73</b>
Long-Term Financial Liabilities	0	0	0	0
Other Non-Current Liabilities	50	62	67	73
<b>Total Liabilities</b>	<b>727</b>	<b>813</b>	<b>779</b>	<b>755</b>
<b>Controlling Interests</b>	<b>941</b>	<b>1,084</b>	<b>1,262</b>	<b>1,458</b>
Capital Stock	41	41	41	41
Capital Surplus	126	126	126	126
Retained Earnings	868	1,018	1,196	1,392
<b>Non-Controlling Interests</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Stockholders' Equity</b>	<b>941</b>	<b>1,084</b>	<b>1,262</b>	<b>1,458</b>

## Cash Flows (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
Cash Flows from Op Activities	537	452	440	496
Net Profit	245	278	314	347
Non-Cash Income and Expense	374	310	300	322
Depreciation	191	131	185	197
Amortization	8	5	7	6
Others	175	174	108	119
Chg in Working Capital	-41	-37	-68	-56
Chg in AR & Other Receivables	67	-37	-19	-18
Chg in Inventories	19	-8	-6	-5
Chg in AP & Other Payables	-82	1	3	3
<b>Income Tax Paid</b>	<b>-41</b>	<b>-99</b>	<b>-106</b>	<b>-117</b>
Cash Flows from Inv Activities	-76	-226	-220	-225
Chg in PP&E	-258	-220	-223	-230
Chg in Intangible Assets	-2	0	0	0
Chg in Financial Assets	-4	-5	-5	-4
<b>Others</b>	<b>188</b>	<b>-1</b>	<b>8</b>	<b>9</b>
Cash Flows from Fin Activities	-373	-78	-147	-162
Chg in Financial Liabilities	-260	-59	0	0
Chg in Equity	0	0	0	0
Dividends Paid	-78	0	-136	-151
<b>Others</b>	<b>-35</b>	<b>-19</b>	<b>-11</b>	<b>-11</b>
Increase (Decrease) in Cash	86	149	73	109
Beginning Balance	152	239	387	460
<b>Ending Balance</b>	<b>239</b>	<b>387</b>	<b>460</b>	<b>569</b>

Source: Company data, KDB Daewoo Securities Research estimates

## Forecasts/Valuations (Summarized)

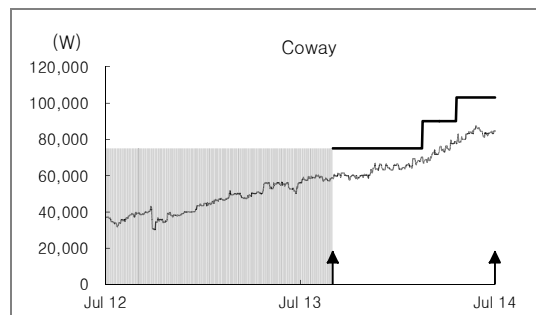
	12/13	12/14F	12/15F	12/16F
P/E (x)	20.9	23.6	20.8	18.9
P/CF (x)	8.3	11.1	10.7	9.8
P/B (x)	4.9	5.5	4.8	4.2
EV/EBITDA (x)	9.7	12.4	10.2	9.3
EPS (W)	3,178	3,605	4,076	4,503
CFPS (W)	8,030	7,620	7,970	8,677
BPS (W)	13,535	15,488	17,800	20,341
DPS (W)	2,710	1,830	2,036	2,240
Payout ratio (%)	82.4	48.9	48.1	47.9
Dividend Yield (%)	4.1	2.2	2.4	2.6
Revenue Growth (%)	6.3	7.2	8.2	7.9
EBITDA Growth (%)	31.0	-3.4	20.0	7.4
Operating Profit Growth (%)	50.0	13.0	12.5	8.1
EPS Growth (%)	160.7	13.4	13.1	10.5
Accounts Receivable Turnover (x)	9.5	9.9	9.6	9.6
Inventory Turnover (x)	30.8	32.9	32.8	33.0
Accounts Payable Turnover (x)	17.4	21.5	22.9	23.3
ROA (%)	14.3	15.6	16.0	16.3
ROE (%)	28.4	27.5	26.8	25.5
ROIC (%)	23.0	29.3	32.3	31.8
Liability to Equity Ratio (%)	77.3	75.0	61.7	51.8
Current Ratio (%)	102.2	118.4	140.0	166.7
Net Debt to Equity Ratio (%)	9.5	-10.8	-15.1	-20.6
Interest Coverage Ratio (x)	18.2	33.7	39.0	42.1

## APPENDIX 1

### Important Disclosures & Disclaimers

#### 2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Coway(O21240)	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 (◆))

\* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.

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<b>Daewoo Securities (Europe) Ltd.</b> 41st Floor, Tower 42 25 Old Broad Street London EC2N 1HQ United Kingdom Tel: 44-20-7982-8000	<b>Daewoo Securities (Singapore) Pte. Ltd.</b> Six Battery Road #11-01 Singapore, 049909  Tel: 65-6671-9845	<b>Tokyo Representative Office</b> 7F, Yusen Building, 2-3-2 Marunouchi, Chiyoda-ku Tokyo 100-0005 Japan Tel: 81-3- 3211-5511
<b>Beijing Representative Office</b> 2401A, 24th Floor. East Tower Twin Tower, B-12 Jianguomenwai Avenue Chaoyang District, Beijing 100022 China Tel: 86-10-6567-9699	<b>Shanghai Representative Office</b> Room 38T31, 38F SWFC 100 Century Avenue, Pudong New Area, Shanghai, 200120 China Tel: 86-21-5013-6392	<b>Ho Chi Minh Representative Office</b> Suites 901B. Centec Tower 72-74 Nguyen Thi Minh Khai St, Ward 6 District 3, HCMC  Tel: 84-8-3910-6000
<b>Daewoo Investment Advisory (Beijing) Co., Ltd</b> 2401B, 24th Floor. East Tower Twin Tower, B-12 Jianguomenwai Avenue Chaoyang District, Beijing 100022 China Tel: 86-10-6567-9699	<b>PT. Daewoo Securities Indonesia</b> Equity Tower 50th Floor Jl. Jend Sudirman, SCBD Lot 9 Jakarta 12190  Tel: 62-21-2553-1000	<b>Daewoo Securities (Mongolia) LLC</b> #406, Blue Sky Tower, Peace Avenue 17 1 Khoroo, Sukhbaatar District Ulaanbaatar 14240 Mongolia Tel: 976-7011-0807