

Earnings review

Korea / Consumer

28 July 2014

**BUY**

Target price **KRW107,000**

Last price (25 July 2014) **KRW92,200**

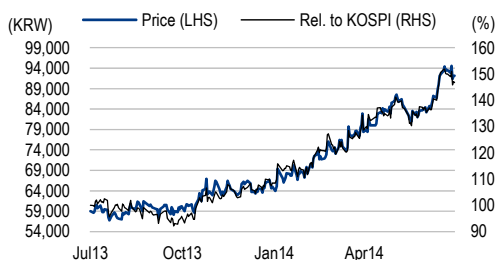
Upside/downside (%)	16.1
KOSPI	2,033.85
Mkt. cap (KRWbn/US\$bn)	7,111/6.9
52-week range (KRW)	56,800 - 94,600
Avg. trading value daily (KRWbn)	17.30
Foreign ownership (%)	54.3

Source: Bloomberg

**Forecast earnings & valuation**

Fiscal year ending	Dec-13	Dec-14 E	Dec-15 E	Dec-16 E
<b>Revenue (KRWbn)</b>	<b>2,118</b>	<b>2,266</b>	<b>2,432</b>	<b>2,572</b>
EBIT (KRWbn)	339.0	405.9	481.2	542.9
<b>Net profit (KRWbn)</b>	<b>245.1</b>	<b>304.4</b>	<b>361.9</b>	<b>410.4</b>
Net profit(underlying)	245.1	304.4	361.9	410.3
EPS (KRW)	3,178	3,947	4,692	5,321
EPS growth (%)	160.6	24.2	18.9	13.4
<b>P/E (x)</b>	<b>20.9</b>	<b>23.4</b>	<b>19.7</b>	<b>17.3</b>
EV/EBITDA (x)	9.7	11.5	9.8	8.7
Dividend yield (%)	2.5	2.4	3.1	3.9
P/B (x)	5.4	6.3	5.4	4.7
<b>ROE (%)</b>	<b>28.4</b>	<b>29.5</b>	<b>29.7</b>	<b>29.0</b>
Net debt/equity (%)	8.8	(4.1)	(14.5)	(23.0)

**Performance**



Performance	1M	3M	12M
Absolute (%)	9.8	17.6	56.8
Absolute (US\$, %)	8.7	18.8	69.9
Relative to KOSPI (%)	7.1	14.4	50.3

Source: Bloomberg

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# COWAY (021240 KS)

## Solid 2Q, firm outlook

Coway has reported solid 2Q operating profit. We expect the company's healthy earnings growth and improving cash management, via higher cash returns to shareholders, to provide positive sentiment on Coway's share price. We reiterate our BUY rating and target price of KRW107,000.

### Solid 2Q, on healthy rental business

During market hours on 28 July, Coway reported healthy 2Q consolidated results. Sales, operating profit and net profit came in at KRW557bn (+0.1% YoY), KRW97.2bn (+19% YoY) and KRW66.3bn (+11% YoY), respectively, with operating profit coming in line with our and consensus estimates. We attribute the healthy YoY growth in 2Q14 to: 1) a rapid recovery in the number of rental service accounts (+24% YoY); 2) the impact of a 5% rental-service fee hike, which Coway implemented in April 2013; and 3) ongoing cost cutting. We expect the healthy operating profit growth trend to continue in 2H14 and 2015. Meanwhile, although net profit came in below our and consensus estimates, we attribute the weaker net profit largely to KRW7.1bn of forex loss. Normalizing for the loss, 2Q14 net profit would be in line with our and consensus estimates.

Figure 1 Coway's 2Q14 earnings review

(KRWbn)	2Q14	2Q13	Chg. (YoY)	2Q14 (Con)	Diff (%)	2Q14 (Mirae)	Diff (%)
Sales	556.9	556.5	0.1	568.1	(2.0)	588.5	(5.4)
Operating profit	97.2	81.9	18.6	97.2	(0.1)	97.2	(0.0)
OPM (%)	17.4	14.7		17.1		16.5	
Net profit	66.3	59.7	11.0	71.0	(6.6)	72.9	(9.0)
NPM (%)	11.9	10.7		12.5		12.4	

Source: Company data, Bloomberg, Mirae Asset Research

### Solid 2014-2015 operating profit growth momentum

We forecast growth in Coway's operating profit of 17% YoY in 2H14 and 19% YoY in 2015. We think key earnings drivers will include: 1) monthly average revenue per user (ARPU) growth of 1-1.5% YoY, following rental-service fee hikes in April 2013; 2) healthy rental and membership subscriber growth of 3-4% YoY for 2014-15, on the back of lower subscription-cancellation ratios; and 3) management's continuing efforts on SG&A cost savings.

### Potential value enhancement from cash management

We expect strong earnings growth and stable capex to result in a CAGR of 12% free cash flow (FCF) in 2014-16. With Coway's net cash position, we think the healthy free cash growth should lead to a sharp increase in dividend payouts to maximize shareholder value. We believe ownership by MBK Partners is dividend-friendly. We expect Coway's dividend per share to rise to KRW2,200 in 2014 and KRW2,900 in 2015.

### Maintain BUY and target price of KRW107,000

The stock is currently trading at 19.7x 2015E PER, which is a 10% premium to its five-year historical average valuation. However, we think the premium should continue to widen, considering: 1) Coway's improved corporate governance and better cash management (under new major shareholder, MBK Partners); 2) stronger EPS and EBITDA growth prospects; 3) higher operating profit margin outlook; and 4) greater dividend payout ratios.

Figure 2 Quarterly earnings estimates

(KRWbn)	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14*	3Q14E	4Q14E	2014E	1Q15E	2Q15E	3Q15E	4Q15E	2015E
Sales	507.4	556.5	530.5	524.0	2,118.3	535.0	588.5	574.9	567.7	2,266.1	572.4	631.4	617.5	610.3	2,431.6
Operating profit	69.7	81.9	96.3	91.1	339.0	90.3	97.2	112.2	106.3	405.9	110.6	115.6	130.8	124.2	481.2
Recurring profit	75.3	81.0	80.4	90.4	327.1	90.3	97.2	112.2	106.3	405.9	110.9	115.9	131.2	124.5	482.5
Income tax	17.9	21.3	20.3	22.5	82.1	22.6	24.3	28.0	26.6	101.5	27.7	29.0	32.8	31.1	120.6
Tax rate (%)	23.8	26.3	25.3	24.9	25.1	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Net profit	57.4	59.7	60.1	67.9	245.1	67.7	72.9	84.1	79.7	304.4	83.2	86.9	98.4	93.4	361.9
<b>Chg (YoY)</b>															
Sales	6.2	13.7	4.7	0.9	6.3	5.4	5.8	8.4	8.3	7.0	7.0	7.3	7.4	7.5	7.3
Operating profit	7.7	27.7	53.2	165.0	49.9	29.5	18.6	16.5	16.7	19.7	22.4	19.0	16.6	16.8	18.5
Recurring profit	21.4	1,724.1	44.5	282.5	124.4	19.9	20.0	39.5	17.5	24.1	22.8	19.3	16.9	17.2	18.9
Net profit	25.0	T/N	40.4	402.6	160.6	18.0	22.1	40.0	17.4	24.2	22.8	19.3	16.9	17.2	18.9
<b>Margins (%)</b>															
Operating margin	13.7	14.7	18.1	17.4	16.0	16.9	16.5	19.5	18.7	17.9	19.3	18.3	21.2	20.4	19.8
Recurring margin	14.8	14.6	15.2	17.3	15.4	16.9	16.5	19.5	18.7	17.9	19.4	18.4	21.2	20.4	19.8
Net margin	11.3	10.7	11.3	13.0	11.6	12.7	12.4	14.6	14.0	13.4	14.5	13.8	15.9	15.3	14.9

Source: COWAY, Mirae Asset Research

Note: \*Figures for 2Q14 are based on our estimates

## Summary financial statements

### Profit & loss

Year end Dec 31 (KRWbn)	2013	2014E	2015E	2016E
<b>Revenue</b>	<b>2,118</b>	<b>2,266</b>	<b>2,432</b>	<b>2,572</b>
Cost of goods sold	721	775	827	879
<b>Gross profit</b>	<b>1,397</b>	<b>1,491</b>	<b>1,605</b>	<b>1,693</b>
SG&A	1,058	1,085	1,123	1,150
<b>EBIT (Adj.)</b>	<b>339</b>	<b>406</b>	<b>481</b>	<b>543</b>
<b>EBIT</b>	<b>339</b>	<b>406</b>	<b>481</b>	<b>543</b>
Net interest income (loss)	(14)	(3)	(1)	2
Income (loss) from associates	0	0	0	0
Others	3	3	3	3
<b>Recurring profit</b>	<b>327</b>	<b>406</b>	<b>483</b>	<b>547</b>
Income tax	82	101	121	137
<b>Net profit</b>	<b>245</b>	<b>304</b>	<b>362</b>	<b>410</b>
<b>Net profit (Controlling Interests)</b>	<b>245</b>	<b>304</b>	<b>362</b>	<b>410</b>
EPS (Controlling Interests, KRW)	3,178	3,947	4,692	5,321

Growth & margins (%)	2013	2014E	2015E	2016E
Revenue growth	6.3	7.0	7.3	5.8
Gross profit growth	6.3	6.7	7.6	5.5
EBIT growth	49.9	19.7	18.5	12.8
Net profit growth	160.6	24.2	18.9	13.4
EPS growth	160.6	24.2	18.9	13.4
Gross margin	66.0	65.8	66.0	65.8
EBIT margin	16.0	17.9	19.8	21.1
Net profit margin	11.6	13.4	14.9	16.0

Source: COWAY, Mirae Asset Research estimates

### Cash flow

Year end Dec 31 (KRWbn)	2013	2014E	2015E	2016E
<b>Cash flow from operations</b>	<b>537</b>	<b>553</b>	<b>584</b>	<b>645</b>
Net profit	245	304	362	410
Depr. & amortization	198	207	223	235
Others	135	44	44	44
Change in working capital	(41)	(2)	(45)	(44)
<b>Cash flow from investing</b>	<b>(74)</b>	<b>(301)</b>	<b>(271)</b>	<b>(271)</b>
Capital expenditures	(268)	(300)	(270)	(270)
Others	194	(1)	(1)	(1)
<b>Cash flow from financing</b>	<b>(373)</b>	<b>(332)</b>	<b>(167)</b>	<b>(217)</b>
Dividends	(78)	(124)	(167)	(217)
Increase in equity	0	0	0	0
Increase in debt	(262)	(208)	0	0
Beginning cash	156	245	166	311
Ending cash	245	166	311	467

Source: COWAY, Mirae Asset Research estimates

### Balance sheet

Year end Dec 31 (KRWbn)	2013	2014E	2015E	2016E
<b>Current assets</b>	<b>691</b>	<b>598</b>	<b>774</b>	<b>958</b>
Cash & equivalents	239	113	122	129
Short-term financial asset	6	52	189	339
Accounts receivable	213	216	232	245
Inventory	66	59	63	67
Other current assets	168	157	168	178
<b>Non-current assets</b>	<b>976</b>	<b>1,069</b>	<b>1,117</b>	<b>1,152</b>
Net fixed assets	638	739	794	836
Investments	2	2	2	2
Other long-term assets	336	328	320	313
<b>Total assets</b>	<b>1,668</b>	<b>1,667</b>	<b>1,891</b>	<b>2,109</b>
<b>Current liabilities</b>	<b>677</b>	<b>373</b>	<b>400</b>	<b>424</b>
Accounts payable	37	39	42	45
Short-term debt	328	0	0	0
Other current liabilities	312	334	358	379
<b>Non-current liabilities</b>	<b>50</b>	<b>172</b>	<b>175</b>	<b>176</b>
Long-term debt	0	120	120	120
Other long-term liabilities	50	52	55	56
<b>Total liabilities</b>	<b>727</b>	<b>545</b>	<b>575</b>	<b>600</b>
Controlling Interests	941	1,122	1,316	1,509
Non-Controlling Interests	0	0	0	0
<b>Shareholder's equity</b>	<b>941</b>	<b>1,122</b>	<b>1,316</b>	<b>1,509</b>
BVPS(KRW)	12,200	14,544	17,065	19,571

Source: COWAY, Mirae Asset Research estimates

### Ratio analysis

Year end Dec 31	2013	2014E	2015E	2016E
ROE (%)	28.4	29.5	29.7	29.0
ROA (%)	14.3	18.3	20.3	20.5
Inventory days	11.8	10.1	9.2	9.2
Receivables days	38.4	34.5	33.6	33.9
Payable days	7.1	6.1	6.1	6.1
Net debt/equity (%)	8.8	(4.1)	(14.5)	(23.0)
Interest cover (x)	23.4	153.8	364.9	(319.8)

Source: COWAY, Mirae Asset Research estimates

**Recommendations****By stock (12 months)**

BUY: A target price + 10% or more above the current price,

HOLD: Target price within - 10% to +10% of the current price

REDUCE: A target price of -10% or less below the current price

**By industry**

OVERWEIGHT: over +10% of the current industry index

NEUTRAL: -10% to +10% of the current industry index

UNDERWEIGHT: -10% or less than the current industry index

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			Number of Shares	Purchase Price	Purchase Date				
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**Target Price and Recommendation Chart**

COWAY (021240 KS)



Date	Recommendation	12M target price (KRW)
2014-05-14	BUY (Initiate)	107,000
2014-06-19	BUY	107,000
2014-07-28	BUY	107,000

Source: Bloomberg, Mirae Asset Research

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