

Coway

(021240 KS)

New rental accounts hit quarterly high

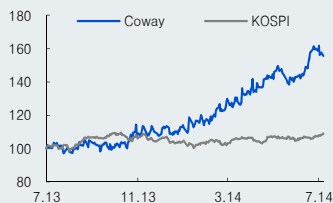
Consumer Services

Results Comment
July 29, 2014

(Maintain)	Buy
Target Price (12M, W)	112,000
Share Price (7/28/14, W)	91,100
Expected Return	23%

OP (14F, Wbn)	377
Consensus OP (14F, Wbn)	390
EPS Growth (14F, %)	9.0
Market EPS Growth (14F, %)	16.5
P/E (14F, x)	26.3
Market P/E (14F, x)	12.0
KOSPI	2,048.81
Market Cap (Wbn)	7,026
Shares Outstanding (mn)	77
Free Float (%)	65.3
Foreign Ownership (%)	54.3
Beta (12M)	0.37
52-Week Low	56,800
52-Week High	94,600

(%)	1M	6M	12M
Absolute	9.5	40.2	54.4
Relative	6.3	31.1	44.0



Daewoo Securities Co., Ltd.

[Hotel/Leisure, Fashion, Consumer Services]

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

2Q review: Parent OP comes in 4.2% above consensus at W97.6bn (+23.0% YoY)

Coway reported 2Q non-consolidated revenue of W523.3bn (+5.3% YoY) and operating profit of W97.6bn (+23.0% YoY). Revenue was in line, while operating profit beat the consensus by 4.2%. The commission rate slightly increased QoQ due to the accelerated inflow of new rental accounts, but overall the company's cost control efforts continued to have positive effects. OP margin came in at 18.7%, above both our forecast (17.2%) and the consensus (17.7%).

Despite the solid increase in operating profit, net profit growth was more modest at 7.7% YoY, which we attribute to valuation losses on foreign currency receivables (W7.1bn in F/X losses). Churn rate inched up QoQ to 1.04% (vs. 0.97% in 1Q), affected by: 1) the heavy concentration of expiring accounts in 1H, and 2) adjustments to inactive accounts. The rental asset disposal ratio remained largely steady at 3.1%.

Catalysts: 1) Stronger-than-expected new rental accounts and 2) robust exports

One of the biggest highlights of the 2Q earnings report was the resumed growth of new rental accounts. In 2013, Coway focused on improving its cost efficiency rather than on driving sales. As a result, the rental business saw better margins, but growth suffered.

This year, the company has been expanding its sales associates and distribution channels to bolster its sales capabilities. Such efforts appear to be paying off: new rental accounts in 2Q hit a quarterly record high of 371,000 (+24.4% YoY), putting to rest any doubts over the company's growth.

Exports, which include sales to overseas subsidiaries and ODM shipments, climbed 25.2% YoY, accounting for 10.6% of overall revenue (up from 7.5% in 2013). The home care division continued its strong performance, with mattress volume and revenue jumping 191% and 48% YoY, respectively. In our view, the robust sales of such new rental products attest to Coway's systemic strength in the rental business.

Reiterate Buy and Lift TP by 8.7% to W112,000

We maintain Buy on Coway and raise our target price by 8.7% to W112,000 (from W103,000), reflecting slight upward revisions to our long-term earnings forecasts. Our discounted cash flow (DCF) valuation method remains unchanged. With limited prospects of a recovery in consumer spending, we believe Coway's efficient rental business model warrants a valuation premium now more than ever.

FY (Dec.)	12/11	12/12	12/13	12/14F	12/15F	12/16F
Revenue (Wbn)	1,824	1,993	2,118	2,223	2,419	2,619
OP (Wbn)	235	226	339	377	432	492
OP Margin (%)	12.9	11.3	16.0	17.0	17.9	18.8
NP (Wbn)	167	94	245	267	311	364
EPS (W)	2,166	1,219	3,178	3,462	4,034	4,720
ROE (%)	22.2	12.3	28.4	26.5	26.8	26.9
P/E (x)	16.9	35.7	20.9	26.3	22.6	19.3
P/B (x)	3.3	3.8	4.9	5.9	5.2	4.5

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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2Q14P review

Table 1. 2Q14P non-consolidated results

(Wbn, %)

	2Q13	1Q14	2Q14P			Growth rate	
			Preliminary	KDB Daewoo	Consensus	YoY	QoQ
Revenue	497	495	523	532	531	5.3	5.8
Operating profit	79	90	98	91	94	23.0	8.7
OP margin	16.0	18.1	18.7	17.2	17.7	2.7	0.5
Pretax profit	81	88	87	89	91	7.4	-1.3
Net profit	61	66	65	67	68	7.7	-1.3

Note: Based on non-consolidated K-IFRS

Source: KDB Daewoo Securities Research estimates

Table 2. 2Q14P consolidated results

(Wbn, %)

	2Q13	1Q14	2Q14P			Growth rate	
			Preliminary	KDB Daewoo	Consensus	YoY	QoQ
Revenue	556	535	557	592	578	0.1	4.1
Operating profit	82	90	97	96	98	18.6	7.7
OP margin	14.7	16.9	17.5	16.2	17.0	18.5	3.4
Pretax profit	81	88	87	93	97	6.8	-2.2
Net profit	60	66	66	69	73	11.1	0.3

Note: Based on consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research estimates

Table 3. Earnings forecast revisions

(Wbn, %)

	Previous		Revised		% chg.		Notes
	14F	15F	14F	15F	14F	15F	
Revenue	2,271	2,458	2,223	2,419	-2.1	-1.6	- Revised down overseas subsidiary earnings, except for US & Malaysia - Reflected F/X translation losses
Operating profit	383	431	377	432	-1.5	0.2	
Pretax profit	372	421	353	411	-5.0	-2.3	
Net profit	278	314	267	310	-4.0	-1.2	

Note: Based on consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research estimates

Table 4. Quarterly earnings

(Wbn, %)

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14P	3Q14F	4Q14F
Revenue	507	556	531	524	535	557	568	563
Operating profit	70	82	96	91	90	97	95	94
OP margin	13.7	14.7	18.1	17.4	16.9	17.4	16.7	16.7
Net profit	57	60	60	68	66	66	67	67
Net margin	11	11	11	13	12	12	12	12
Rental asset disposal losses	12	10	9	8	10	11	11	11
(% of parent rental revenue)	4	3	3	2	3	3	3	3

Note: Based on consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research estimates

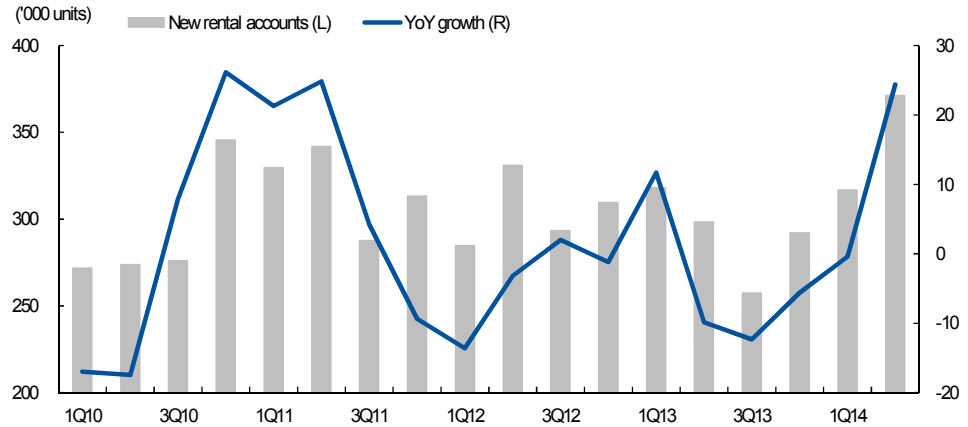
Table 5. DCF valuation

(Wbn, %, '000 shares)

	14F	15F	16F	17F	18F
EBIT	377	432	492	502	512
- Taxes	92	106	120	123	125
- Capex	249	253	263	268	273
- Chg. in working capital	-86	73	62	63	65
+ Depreciation	131	187	198	202	206
+ Amortization	8	8	8	8	8
+ Rental asset disposal losses	42	45	48	48	49
FCFF	302	240	301	306	312
Final year FCFF	290				
Terminal value	9,352				
Terminal growth	2.0%				
NPV of FCFF		1,227			
PV of terminal value		7,269			
Enterprise value		8,496			
Cash & equivalents		364			
Other investment		6			
Interest-bearing debt		257			
Minority interest		0			
Preferred stock		0			
Current equity value		8,610			
Shares outstanding		77,125			
Target price (W)		112,000			
Current price (W)		91,100			
Upside (%)		22.9%			

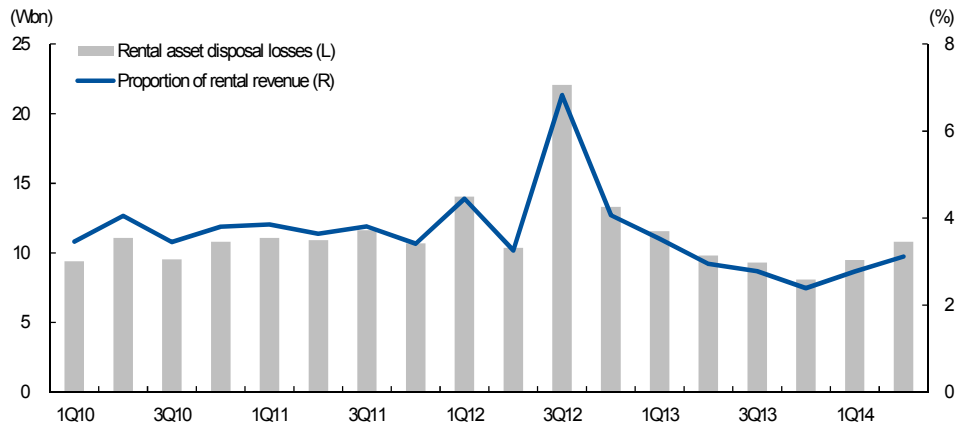
Source: Company data, KDB Daewoo Securities Research

Figure 1. New rental account additions in 2Q14 surged by 24%, reaching a new historic high



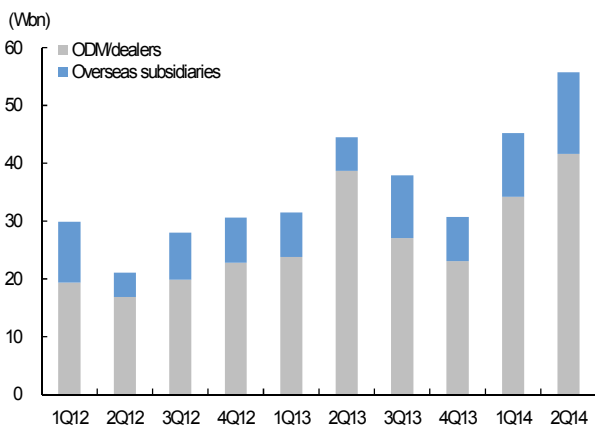
Source: Company data, KDB Daewoo Securities Research

Figure 2. Quarterly rental asset disposal losses: Steady at around 3% level



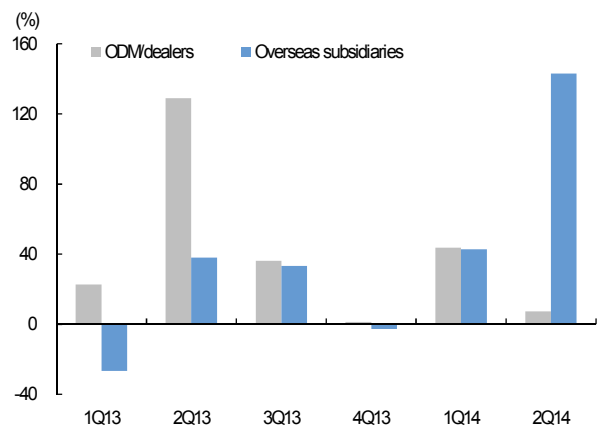
Source: Company data, KDB Daewoo Securities Research

Figure 3. Export volume maintained strong growth



Source: Company data, KDB Daewoo Securities Research

Figure 4. Exports to overseas subsidiaries showed outstanding growth



Source: Company data, KDB Daewoo Securities Research

Coway (021240 KS/Buy/TP: W112,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
Revenue	2,118	2,223	2,419	2,619
Cost of Sales	721	754	817	892
Gross Profit	1,397	1,469	1,602	1,727
SG&A Expenses	1,058	1,093	1,169	1,235
Operating Profit (Adj)	339	377	432	492
Operating Profit	339	377	432	492
Non-Operating Profit	-12	-23	-20	-10
Net Financial Income	-14	-7	-5	-3
Net Gain from Inv in Associates	18	0	0	0
Pretax Profit	327	354	412	482
Income Tax	82	87	101	118
Profit from Continuing Operations	245	267	311	364
Profit from Discontinued Operations	0	0	0	0
Net Profit	245	267	311	364
Controlling Interests	245	267	311	364
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	244	262	311	364
Controlling Interests	244	262	311	364
Non-Controlling Interests	0	0	0	0
EBITDA	537	508	619	690
FCF (Free Cash Flow)	269	192	177	241
EBITDA Margin (%)	25.4	22.9	25.6	26.3
Operating Profit Margin (%)	16.0	17.0	17.9	18.8
Net Profit Margin (%)	11.6	12.0	12.9	13.9

Statement of Financial Condition (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
Current Assets	691	860	949	1,085
Cash and Cash Equivalents	239	364	417	520
AR & Other Receivables	227	258	279	298
Inventories	66	71	77	82
Other Current Assets	159	167	176	185
Non-Current Assets	976	1,004	1,030	1,051
Investments in Associates	0	0	0	0
Property, Plant and Equipment	638	655	677	693
Intangible Assets	177	179	179	179
Total Assets	1,668	1,864	1,978	2,135
Current Liabilities	677	728	661	605
AP & Other Payables	191	196	211	226
Short-Term Financial Liabilities	335	257	228	201
Other Current Liabilities	151	275	222	178
Non-Current Liabilities	50	62	67	73
Long-Term Financial Liabilities	0	0	0	0
Other Non-Current Liabilities	50	62	67	73
Total Liabilities	727	791	728	678
Controlling Interests	941	1,073	1,250	1,457
Capital Stock	41	41	41	41
Capital Surplus	126	126	126	126
Retained Earnings	868	1,007	1,184	1,391
Non-Controlling Interests	0	0	0	0
Stockholders' Equity	941	1,073	1,250	1,457

Cash Flows (Summarized)

(Wbn)	12/13	12/14F	12/15F	12/16F
Cash Flows from Op Activities	537	441	430	504
Net Profit	245	267	311	364
Non-Cash Income and Expense	374	301	288	314
Depreciation	191	131	187	198
Amortization	8	0	0	0
Others	175	170	101	116
Chg in Working Capital	-41	-35	-68	-56
Chg in AR & Other Receivables	67	-33	-19	-18
Chg in Inventories	19	-7	-6	-5
Chg in AP & Other Payables	-82	0	3	3
Income Tax Paid	-41	-91	-101	-118
Cash Flows from Inv Activities	-76	-220	-204	-209
Chg in PP&E	-258	-211	-208	-215
Chg in Intangible Assets	-2	0	0	0
Chg in Financial Assets	-4	-4	-5	-4
Others	188	-5	9	10
Cash Flows from Fin Activities	-373	-97	-173	-193
Chg in Financial Liabilities	-260	-78	-28	-28
Chg in Equity	0	0	0	0
Dividends Paid	-78	0	-134	-157
Others	-35	-19	-11	-8
Increase (Decrease) in Cash	86	125	54	102
Beginning Balance	152	239	364	417
Ending Balance	239	364	417	520

Source: Company data, KDB Daewoo Securities Research estimates

Forecasts/Valuations (Summarized)

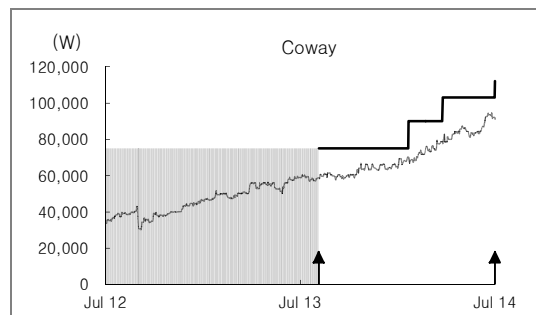
	12/13	12/14F	12/15F	12/16F
P/E (x)	20.9	26.3	22.6	19.3
P/CF (x)	8.3	12.4	11.7	10.4
P/B (x)	4.9	5.9	5.2	4.5
EV/EBITDA (x)	9.7	13.6	11.0	9.7
EPS (W)	3,178	3,462	4,034	4,720
CFPS (W)	8,030	7,360	7,766	8,793
BPS (W)	13,535	15,345	17,638	20,327
DPS (W)	2,710	1,809	2,108	2,466
Payout ratio (%)	82.4	50.3	50.3	50.3
Dividend Yield (%)	4.1	2.0	2.3	2.7
Revenue Growth (%)	6.3	5.0	8.8	8.3
EBITDA Growth (%)	31.0	-5.4	21.9	11.5
Operating Profit Growth (%)	50.0	11.2	14.6	13.9
EPS Growth (%)	160.7	8.9	16.5	17.0
Accounts Receivable Turnover (x)	9.5	9.8	9.6	9.6
Inventory Turnover (x)	30.8	32.5	32.7	33.0
Accounts Payable Turnover (x)	17.4	20.6	21.4	21.8
ROA (%)	14.3	15.1	16.2	17.7
ROE (%)	28.4	26.5	26.8	26.9
ROIC (%)	23.0	29.3	33.1	34.6
Liability to Equity Ratio (%)	77.3	73.7	58.3	46.5
Current Ratio (%)	102.2	118.1	143.5	179.3
Net Debt to Equity Ratio (%)	9.5	-10.6	-15.7	-22.4
Interest Coverage Ratio (x)	18.2	34.4	44.3	57.7

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Coway (021240)	07/28/2014	Buy	112,000
	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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KDB Daewoo Securities International Network

Daewoo Securities Co. Ltd. (Seoul)

Head Office
34-3 Yeouido-dong, Yeongdeungpo-gu
Seoul 150-716
Korea
Tel: 82-2-768-3026

Daewoo Securities (Europe) Ltd.

41st Floor, Tower 42
25 Old Broad St.
London EC2N 1HQ
United Kingdom
Tel: 44-20-7982-8000

Beijing Representative Office

2401A, 24th Floor, East Tower, Twin Towers
B-12 Jianguomenwai Avenue
Chaoyang District, Beijing 100022
China
Tel: 86-10-6567-9299

Daewoo Investment Advisory (Beijing) Co., Ltd.

2401B, 24th Floor, East Tower, Twin Towers
B-12 Jianguomenwai Avenue,
Chaoyang District, Beijing 100022
China
Tel: 86-10-6567-9699

Daewoo Securities (Hong Kong) Ltd.

Two International Finance Centre
Suites 2005-2012
8 Finance Street, Central
Hong Kong, China
Tel: 85-2-2845-6332

Daewoo Securities (Singapore) Pte. Ltd.

Six Battery Road #11-01
Singapore, 049909

Tel: 65-6671-9845

Shanghai Representative Office

Room 38T31, 38F SWFC
100 Century Avenue
Pudong New Area, Shanghai 200120
China
Tel: 86-21-5013-6392

Daewoo Securities (Mongolia) LLC

#406, Blue Sky Tower, Peace Avenue 17
1 Khoroo, Sukhbaatar District
Ulaanbaatar 14240
Mongolia
Tel: 976-7011-0807

Daewoo Securities (America) Inc.

320 Park Avenue
31st Floor
New York, NY 10022
United States
Tel: 1-212-407-1000

Tokyo Branch

7th Floor, Yusen Building
2-3-2 Marunouchi, Chiyoda-ku
Tokyo 100-0005
Japan
Tel: 81-3- 3211-5511

Ho Chi Minh Representative Office

Suite 2103, Saigon Trade Center
37 Ton Duc Thang St,
Dist. 1, Ho Chi Minh City,
Vietnam
Tel: 84-8-3910-6000

PT. Daewoo Securities Indonesia

Equity Tower Building Lt.50
Sudirman Central Business District Jl.
Jendral Sudirman Kav. 52-53, Jakarta Selatan
Indonesia 12190
Tel: 62-21-515-1140
