

Coway (021240)

12M rating **BUY (Maintain)**

12M TP **W106,000** from W106,000

Up/downside **+26%**

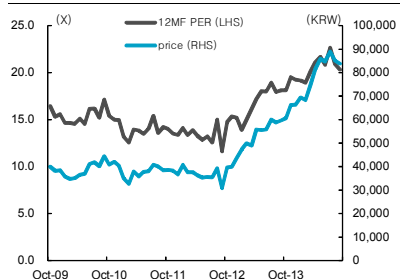
Stock Data

KOSPI (Sep 3, pt)	2,051
Stock price (Sep 3, KRW)	83,800
Market cap (USD mn)	6,336
Shares outstanding (mn)	77
52-Week high/low (KRW)	94,600/57,500
6M avg. daily turnover (USD mn)	18.0
Free float / Foreign ownership (%)	65.3/54.9
Major shareholders (%)	
Coway Holdings, Inc. and 11 others	31.0

Performance

	1M	6M	12M
Absolute (%)	(4.1)	19.0	40.1
Relative to KOSPI (%p)	(3.1)	14.6	34.1

12MF PE trend



Source: WISEfn consensus

Overall investment merit intact

Share pullback review, no need to worry

Since peaking after 2Q14 earnings were released, Coway shares have pulled back 12%, on: 1) a lack of catalysts after the 2Q peak season, 2) off-season effects and concerns over 3Q14 results, and 3) profit taking. We believe 3Q14 results will fall slightly short of consensus, with separate sales growing 4% YoY to W506.3bn (3% below consensus) and OP falling 3% YoY to W93.9bn (6% below consensus). Results should be soft as exports are sluggish and costs, including marketing, increase compared to 1H14. Specifically, exports should be undermined by base effect as exports surged 90% YoY in 3Q13, and as orders were focused in 1H14. But, orders should rebound from 4Q14. And, exports should continue to grow over the mid to long term backed by the rapid growth of the air purifier market in China. Meanwhile, water purifiers and mattresses should continue to fuel top-line growth. New sales should grow 26% YoY to 320,000 in 3Q14, while rental accounts should grow on a net basis compared to 2Q14.

Core rental sales to pick up in 2H14, to lift total sales from 4Q14

Sales growth slowed to 5.8% YoY in 2H13 and 1H14, respectively. And, concerns are mounting as growth should slow to 3.9% in 3Q14, the slowest in two years. However, growth should accelerate to 9% in 4Q14. Core rental sales (comprising 80% of sales) should pick up from 3Q14, in addition to the strong exports. Of note, total accounts grew only 0.8% YoY in 1Q14 and 1.8% YoY in 2Q14 on membership outflows and weak sales in 2013. However, new rental sales are recovering, and the company posted both record sales in 2Q14 and material new account growth. Going forward, total accounts should grow 3.4% YoY in 3Q14 and 4.6% YoY in 4Q14 on recovering water purifier sales, solid mattress sales and peak seasonal demand for air purifiers and bidets. Rental sales growth should also recover to 6.3% in 2H14 from 4.5% in 1H14. As such, full-year growth should reach 5.1% this year and climb to 7.6% in 2015, versus 4.5% in 2013.

Maintain BUY on recovering core businesses and new growth drivers

We maintain BUY with a TP of W106,000 (25x 12MF PE). We revised down our 2014 OP forecast by 1% on a slightly lower 3Q14 outlook. We maintain a positive view given solid cash flows on increasing demand for domestic environmental home appliances and increased focused on overseas markets. Shares currently trade at 18.5x 2015 PE following the pullback, despite a high ROE and payout ratio compared to other consumer goods plays. Dividend yield should reach 2.4% in 2014 and 2.9% in 2015, as payout ratio should grow on higher net cash flows in 2015 as debt continues to narrow. Dividend merit should be highlighted in 4Q14.

Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
2012A	1,993	226	94	1,267	(43.3)	410	34.4	9.0	3.8	12.3	-
2013A	2,118	339	245	3,283	159.1	537	20.2	9.5	4.9	28.4	4.1
2014F	2,245	382	282	3,790	15.4	573	22.1	11.1	5.5	28.0	2.4
2015F	2,454	439	332	4,470	18.0	631	18.7	10.0	4.9	28.9	2.9
2016F	2,682	503	383	5,153	15.3	696	16.3	8.9	4.3	29.1	3.3

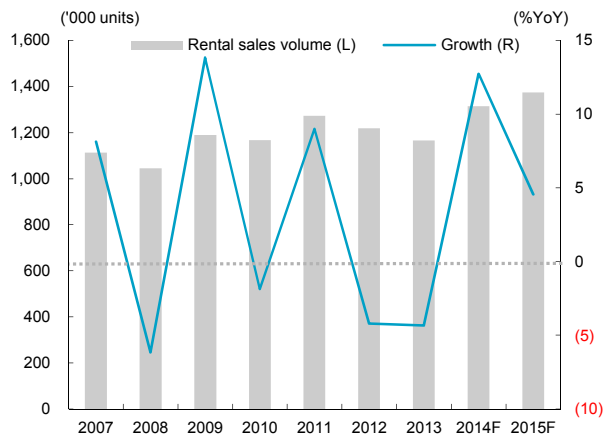
Note: Net profit and EPS are based on figures attributed to controlling interest

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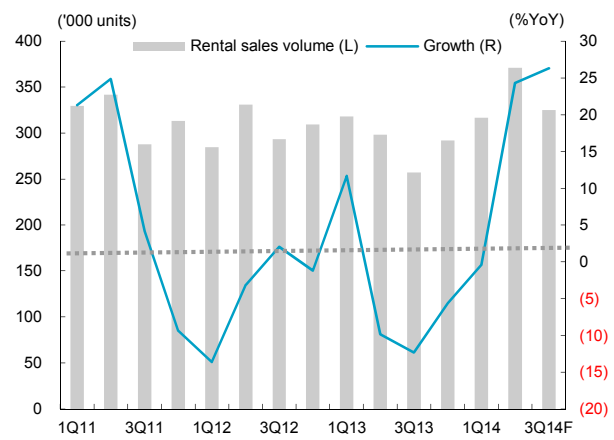
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Figure 1. New rental sales rebound in 2014



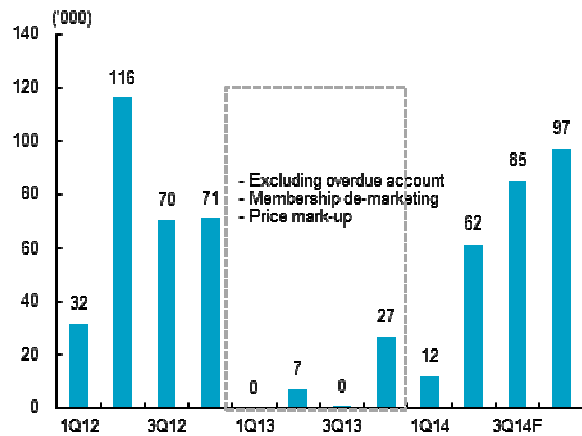
Source: Coway, Korea Investment securities & Investment

Figure 2. Quarterly rental sales remain favorable in 3Q14



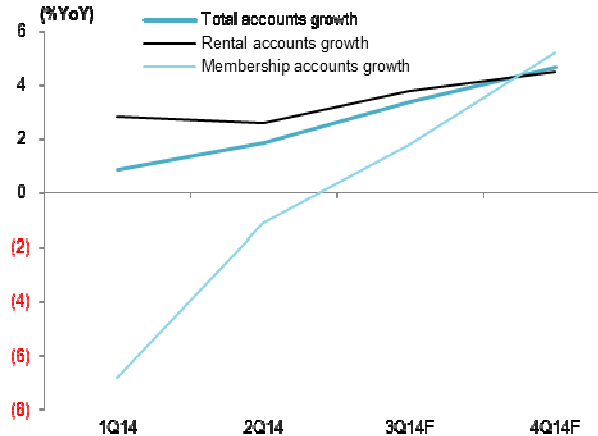
Source: Coway, Korea Investment securities & Investment

Figure 3. Total accounts rebound from 2Q14



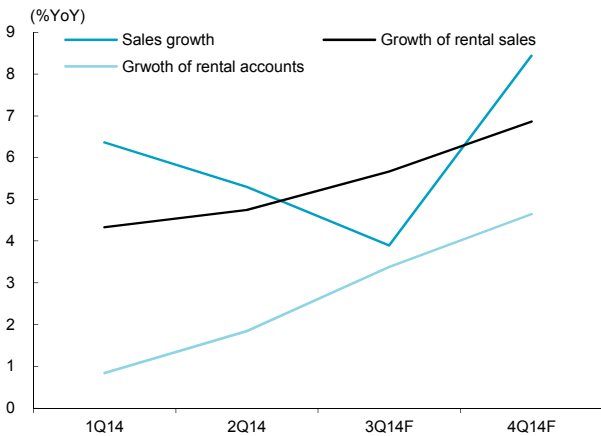
Source: Coway, Korea Investment securities & Investment

Figure 4. Total accounts to grow 3.4% in 3Q14, 4.6% in 4Q14



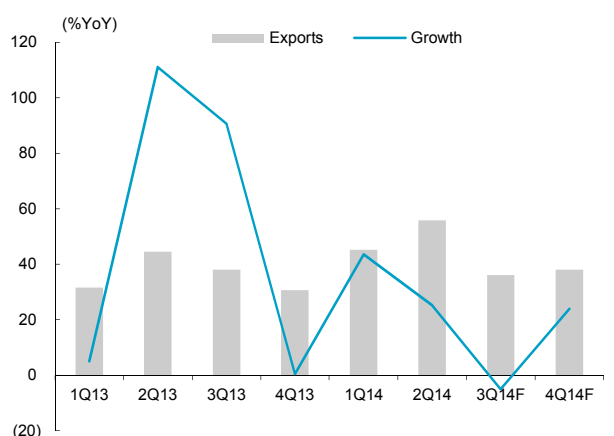
Source: Coway, Korea Investment securities & Investment

Figure 5. Sales to bottom in 3Q14 but rentals to grow



Source: Coway, Korea Investment securities & Investment

Figure 6. Exports to slow YoY, but rebound in 4Q14



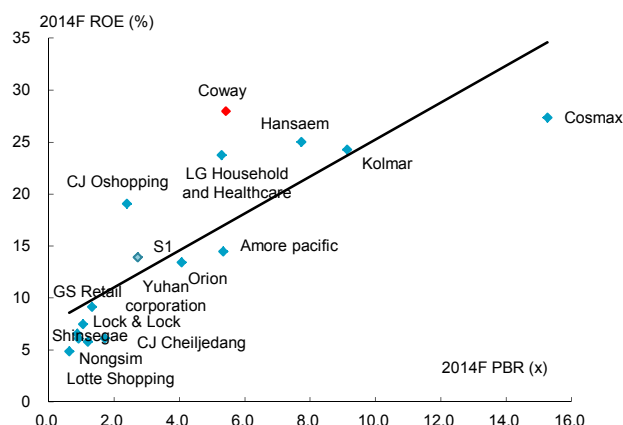
Source: Coway, Korea Investment securities & Investment

Figure 7. Coway band chart



Source: Quantwise, Korea Investment securities & Investment

Figure 8. PB/ROE comparison



Source: Quantwise, Korea Investment securities & Investment

Table 1. Earnings breakdown

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

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Total no. of accounts	5,201	5,333	5,411	5,452	5,484	5,600	5,670	5,741	5,467	5,474	5,474	5,501	5,513	5,574	5,659	5,757
Increase in total account (QoQ)	118	132	78	41	32	116	70	71	NM	7	0	27	12	62	85	97
%YoY	8.4	9.6	9.7	7.3	5.4	5.0	4.8	5.3	NM	NM	NM	NM	0.8	1.8	3.4	4.6
No. of rental account ('000, end of Q)	4,234	4,321	4,377	4,450	4,480	4,518	4,551	4,607	4,332	4,374	4,387	4,435	4,455	4,487	4,552	4,635
Increase in rental account (QoQ)	89	87	55	73	30	38	34	56	NA	43	12	48	20	32	65	82
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	1,087	1,107	1,122
Increase in membership accounts (QoQ)	29	44	23	(32)	2	78	36	15	2	(36)	(12)	(21)	(8)	29	20	15
No. of new rental sales ('000 units)	330	342	288	313	285	331	294	310	318	298	257	292	317	371	325	302
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)	24.3	26.3	3.3
Churn rate (%)	1.0	1.0	1.0	1.1	1.0	1.0	1.0	1.0	1.0	1.0	0.9	0.7	1.0	1.0	1.0	1.0
Total ARPU (Won)	21,206	21,493	21,511	21,706	21,715	21,667	21,550	21,595	22,021	22,831	23,024	23,347	23,380	23,598	23,708	23,985
Total ARPU (%YoY)	(1.3)	0.4	0.5	1.2	2.4	0.8	0.2	(0.5)	NM	NM	NM	NM	NM	3.4		1,314
Rental ARPU (Won)	22,218	22,586	22,845	22,993	23,164	23,319	23,325	23,357	NM	25,176	25,253	25,381	25,676	25,850	25,979	26,288
Rental ARPU (%YoY)	1.0	2.4	3.4	3.6	4.3	3.2	2.1	1.6	NM	NM	NM	NM	NM	2.7	2.9	3.6
Membership ARPU (Won)	13,686	13,457	13,347	13,348	12,948	12,594	12,446	12,467	12,573	12,753	13,159	13,498	13,773	14,213	14,355	14,495
Membership (%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	11.5	9.1	7.4
Sales	400	436	430	444	442	446	458	460	465	497	489	482	495	523	508	523
%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	6.4	5.3	3.9	8.4
Rental	327	340	347	354	356	360	364	370	370	375	378	384	386	392	400	411
%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	4.3	4.7	5.7	6.9
Lump sum payment	32	39	41	32	33	41	39	32	37	48	35	29	28	37	34	33
%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)	(21.7)	(5.0)	11.0
Cosmetics	17	18	18	15	17	16	17	17	18	22	17	20	21	22	18	23
%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	0.7	8.0	15.6
Export	18	23	25	32	30	21	20	31	32	45	38	31	45	56	36	38
%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	25.2	(5.0)	24.0
Others	5	17	0	11	7	8	17	11	9	8	21	20	15	15	21	19
%YoY	(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	95.9	0.0	(4.8)
Gross profit	274	295	295	294	297	304	306	294	311	329	319	323	326	343	329	345
Gross profit 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	65.8	65.5	64.8	65.9
OP	70	73	73	28	64	65	63	36	69	79	97	88	90	98	94	98
%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	23.0	(3.2)	12.1
OPM (%)	17.4	16.7	17.0	6.3	14.5	14.6	13.7	7.7	14.9	16.0	19.8	18.2	18.1	18.7	18.5	18.8

Source: Coway, Korea Investment securities & Investment

Table 2. Overview of major EHA market

(W bn, '000 units, %, '000 accounts)

	Market size	Annual sales volume	Penetration	Estimated saturation rate	Coway market share	Accounts (sales volume)	Sales type
Water purifiers	1,8tn	1,200	34.0%	55~60%	50%	3,020	Rental/membership/lump-sum payment
Bidets	500	800-1,000	18.0%	50~60%	43%	1,350	Rental/membership/lump-sum payment
Air purifiers (Korea)	500	400	12.3%	45~50%	41%	960	Rental/membership/lump-sum payment
Air purifiers (China)	850	2,400	0.1%	45~50%	45%	500	Lump-sum payment/ODM
Mattresses (incl. frames)	800	700	70.0%	70%	10%	140	Rental/membership/lump-sum payment
Dehumidifiers	300	1,000	12.0%	50%	10%	100	Lump-sum payment
Water	100	NA	NA	NA	NA	360	Rental/membership/lump-sum payment
Food waste treatment system	Less than W100bn	NA	NA	NA	NA	36	Rental/membership/lump-sum payment

Source: Industry data, Korea Investment & Securities

Company overview & Glossary

Coway makes and sells environmental home appliances (EHA) such as water/air purifiers, bidets, etc. The company mainly provides products through rentals and outright purchases to customers. Coway is the domestic leader in terms of market share and brand recognition with approximately 5.87mn accounts (rental users + memberships) as of end-2013. The company continues to expand its product lineup, which includes water/air purifiers, bidets, water softeners, food waste treatment systems, mattresses, etc., and is also stepping up overseas operations.

- Rental: Customers gain the right to use a product by paying for registration and monthly rental fees
- Membership: Customers that have purchased a product or gained ownership receive services for product maintenance
- Outright purchase: A lump-sum payment made for a product with no maintenance service offered
- ARPU: Average revenue per user

Balance sheet

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Current assets	779	691	733	819	922
Cash & cash equivalent	152	239	253	294	349
Accounts & other receivables	262	250	264	289	316
Inventory	72	66	70	76	83
Non-current assets	976	976	1,016	1,068	1,123
Investment assets	54	55	58	64	70
Tangible assets	630	638	657	676	695
Intangible assets	184	177	187	205	224
Total assets	1,755	1,668	1,748	1,887	2,045
Current liabilities	759	677	621	601	579
Accounts & other payables	236	224	238	260	284
ST debt & bond	330	182	132	82	32
Current portion of LT debt	110	146	146	146	146
Non-current liabilities	211	50	53	58	64
Debentures	118	0	0	0	0
LT debt & financial liabilities	36	0	0	0	0
Total liabilities	970	727	674	659	643
Controlling interest	785	941	1,074	1,228	1,403
Capital stock	41	41	41	41	41
Capital surplus	126	126	126	126	126
Other Reserves	(85)	(94)	(94)	(94)	(94)
Retained earnings	701	868	1,001	1,155	1,330
Minority interest	0	0	0	0	0
Shareholders' equity	785	941	1,074	1,228	1,403

Cash flow

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
C/F from operating	454	537	443	513	559
Net profit	94	245	282	332	383
Depreciation	175	191	183	183	183
Amortization	8	8	8	9	9
Net incr. in W/C	(24)	(41)	(31)	(12)	(17)
Others	201	134	1	1	1
C/F from investing	(319)	(76)	(230)	(243)	(247)
CAPEX	(314)	(268)	(202)	(202)	(202)
Decr. in fixed assets	4	10	0	0	0
Incr. in investment	(3)	180	(3)	(5)	(6)
Net incr. in intangible assets	(8)	(2)	(18)	(26)	(29)
Others	2	4	(7)	(10)	(10)
C/F from financing	(76)	(373)	(199)	(228)	(258)
Incr. in equity	12	5	0	0	0
Incr. in debts	20	(262)	(50)	(50)	(50)
Dividends	(78)	(78)	(202)	(149)	(178)
Others	(30)	(38)	53	(29)	(30)
C/F from others	(5)	(1)	0	0	0
Increase in cash	54	86	14	42	54

Note: Based on K-IFRS (consolidated)

Income statement

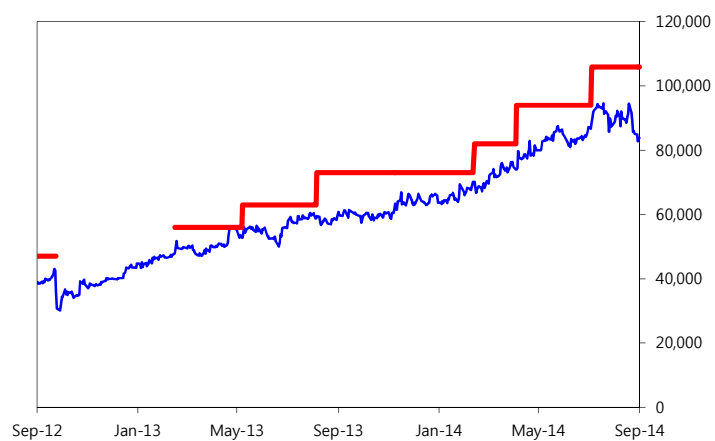
FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Sales	1,993	2,118	2,245	2,454	2,682
COGS	678	721	779	832	898
Gross profit	1,315	1,397	1,466	1,622	1,784
SG&A expense	1,088	1,058	1,084	1,183	1,281
Operating profit	226	339	382	439	503
Financial income	2	4	(1)	7	8
Interest income	2	4	6	7	8
Financial expense	30	19	9	8	6
Interest expense	30	19	9	8	6
Other non-operating profit	(58)	(15)	0	0	0
Gains (Losses) in associates, subsidiaries and JV	5	18	0	0	0
Earnings before tax	146	327	372	438	505
Income taxes	52	82	90	106	122
Net profit	94	245	282	332	383
Net profit of controlling interest	94	245	282	332	383
Other comprehensive profit	5	(1)	0	0	0
Total comprehensive profit	99	244	282	332	383
Total comprehensive profit of controlling interest	99	244	282	332	383
EBITDA	410	537	573	631	696

Key financial data

FY-ending Dec.	2012A	2013A	2014F	2015F	2016F
per share data (KRW)					
EPS	1,267	3,283	3,790	4,470	5,153
BPS	11,354	13,535	15,262	17,257	19,523
DPS	0	2,710	2,000	2,400	2,800
Growth (%)					
Sales growth	9.2	6.3	6.0	9.3	9.3
OP growth	(3.7)	49.9	12.6	15.0	14.6
NP growth	(43.7)	160.6	15.0	17.9	15.3
EPS growth	(43.3)	159.1	15.4	18.0	15.3
EBITDA growth	3.9	31.1	6.6	10.1	10.3
Profitability (%)					
OP margin	11.3	16.0	17.0	17.9	18.8
NP margin	4.7	11.6	12.6	13.5	14.3
EBITDA margin	20.6	25.4	25.5	25.7	25.9
ROA	5.6	14.3	16.5	18.3	19.5
ROE	12.3	28.4	28.0	28.9	29.1
Dividend yield	-	4.1	2.4	2.9	3.3
Dividend payout ratio	0.0	82.4	52.8	53.6	54.3
Stability					
Net debt (W bn)	439	90	25	(67)	(172)
Debt/equity ratio (%)	75.7	35.6	26.5	19.1	13.2
Valuation (X)					
PE	34.4	20.2	22.1	18.7	16.3
PB	3.8	4.9	5.5	4.9	4.3
EV/EBITDA	9.0	9.5	11.1	10.0	8.9

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
	07-08-14	BUY	W106,000



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- BUY: Expected to give a return of +15% or more
- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of -15% or less
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- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- 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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Korea Investment & Securities Co., Ltd., or its affiliates was not making a market in Coway's securities at the time that the research report was published.

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Korea Investment & Securities Co., Ltd. has not provided this report to various third parties.

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Korea Investment & Securities Co., Ltd. has issued ELW with underlying stocks of Coway and is the liquidity provider.

Prepared by: Eun-chaе Na

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