

Company update / Target price lowered

Korea / Consumer

5 September 2014

BUYTarget price **KRW105,000**Last price (2 Sep 2014) **KRW82,800**

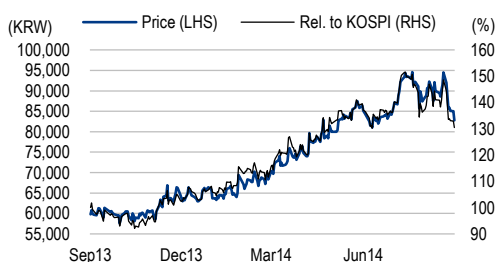
Upside/downside (%)	26.8
KOSPI	2,051.58
Mkt. cap (KRWbn/US\$bn)	6,386/6.3
52-week range (KRW)	57,500 - 94,600
Avg. trading value daily (KRWbn)	17.30
Foreign ownership (%)	55.0

Source: Bloomberg

Forecast earnings & valuation

Fiscal year ending	Dec-13	Dec-14 E	Dec-15 E	Dec-16 E
Revenue (KRWbn)	2,118	2,235	2,398	2,536
EBIT (KRWbn)	339.0	388.4	474.3	534.6
Net profit (KRWbn)	245.1	284.9	355.8	403.3
Net profit(underlying)	245.1	284.9	355.8	403.3
EPS (KRW)	3,178	3,694	4,613	5,229
EPS growth (%)	160.6	16.2	24.9	13.4
P/E (x)	20.9	22.4	17.9	15.8
EV/EBITDA (x)	9.7	10.7	8.9	7.9
Dividend yield (%)	2.5	2.5	3.5	4.2
P/B (x)	5.4	5.8	4.9	4.3
ROE (%)	12.3	28.4	27.9	29.6
Net debt/equity (%)	8.8	(2.4)	(13.6)	(22.1)

Change to EPS	Dec-13	Dec-14 E	Dec-15 E	Dec-16 E
New (KRW)	3,178	3,694	4,613	5,229
Previous (KRW)	3,178	3,947	4,692	5,321

Performance

Performance	1M	3M	12M
Absolute (%)	(5.3)	(4.2)	42.0
Absolute (US\$, %)	(4.2)	(3.6)	55.4
Relative to KOSPI (%)	(4.2)	(6.6)	35.4

Source: Bloomberg

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COWAY (021240 KS)**Solid operations**

We expect Coway's 3Q14 operating profit to remain essentially flat YoY, at KRW94.6bn (-1.7% YoY), due to higher promotional and advertising (P&A) expenses, along with new product launches. However, we think YoY operating profit growth should recover from 4Q, along with controlled P&A expenses and solid top-line growth. We think recent share price weakness, due to weaker 3Q14 earnings growth, provides a good buying opportunity.

Weak 3Q14 OP growth, but growth should recover from 4Q

We expect 3Q14 consolidated operating profit to remain at KRW94.6bn (-1.7% YoY), below our previous estimates and market consensus by 16 and 7%, respectively, due to higher P&A expenses, along with new product launches. We expect P&A expenses as a percentage of sales to rise to 5% in 3Q14 (vs. 3Q13's 3.2%). However, we think YoY operating profit growth should recover from 4Q, along with controlled P&A expenses and solid top-line growth. Meanwhile, the overall competitive landscape in the core rental business has remained soft in 3Q, with growth in Coway's new rental contracts of over 20% YoY, helped by new rental products and strengthened marketing activities.

Figure 1 Coway's 3Q14 earnings preview

(KRWbn)	3Q14E	3Q13	Chg. (YoY)	3Q14 (Con)	Diff (%)	3Q14E (previous)	Diff (%)
Sales	574.9	530.5	8.4	558.5	2.9	574.9	0.0
Operating profit	94.6	96.3	(1.7)	101.8	(7.0)	112.2	(15.6)
OPM (%)	16.5	18.1		18.2		19.5	
Net profit	72.4	60.1	20.5	69.1	4.8	84.1	(13.9)
NPM (%)	12.6	11.3		12.4		14.6	

Source: Company data, Bloomberg, Mirae Asset Research

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 KRW2,100 in 2014 and KRW2,900 in 2015.

Maintain BUY with lower target price of KRW105,000

Reflecting: 1) higher P&A expenses for 3Q14; and 2) KRW7bn in forex-related losses in 2Q14, we lowered our FY14E-15E EPS estimates by 6.4% and 1.7%, respectively. Accordingly, we lowered our DDM-based target price slightly to KRW105,000 from KRW107,000. Since peaking at KRW94,500 on 22 August, the share price has fallen 12%, due to market concerns over weak 3Q14 earnings growth. We believe the weaker 3Q earnings growth is mostly priced into the current share price. The stock is now trading at 17.9x 2015E PER, roughly at par with its five-year historical average; however, we think the par valuation is too conservative, 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 Earnings revisions

	New		Previous		Diff (%)	
	FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
(KRWbn)						
Sales	2,235	2,398	2,266	2,432	(1.4)	(1.4)
Operating profit	388	474	406	481	(4.3)	(1.4)
Net profit (for controlling stake only)	285	356	304	362	(6.4)	(1.7)
EPS (Won)	3,694	4,613	3,947	4,692	(6.4)	(1.7)
Margin (%)						
Operating profit	17.4	19.8	17.9	19.8		
Net profit (for controlling stake only)	12.7	14.8	13.4	14.9		

Source: Mirae Asset Research

Figure 3 DDM valuation

(KRW)	2014E	2015E	2016E	2017E	2018E
DPS forecast/share	2,100	2,900	3,500	4,200	4,900
Cost of equity (%)	6.1	6.1	6.1	6.1	6.1
Discounting factor (x)	1.06	1.13	1.19	1.27	1.34
NPV of DPS	1,979	2,576	2,931	3,315	3,645
Terminal value/share					121,355

Terminal growth rate	3%
PV of terminal value/share	90,283
Fair value/share	105,000
Number of shares (m)	77.1
Fair valuation (KRW bn)	8,098

Cost of equity calculation	
Risk free rate (%)	2.8
Beta (x)	0.5
Korea risk premium (%)	6.1
Cost of equity (%)	6.1

Sensitivity Analysis					
Cost of Equity	Implied dividend growth				
	2.0%	2.5%	3.0%	3.5%	4.0%
5.1%	109,000	127,000	155,000	200,000	285,000
5.6%	93,000	107,000	125,000	152,000	196,000
6.1%	82,000	92,000	105,000	123,000	149,000
6.6%	73,000	81,000	90,000	103,000	120,000
7.1%	66,000	72,000	79,000	89,000	101,000

Source: Mirae Asset Research

Figure 4 Quarterly earnings estimates

(KRW bn)	1Q13	2Q13	3Q13	4Q13	2013E	1Q14	2Q14	3Q14E	4Q14E	2014E	1Q15E	2Q15E	3Q15E	4Q15E	2015E
Sales	507.4	556.5	530.5	524.0	2,118.3	535.0	556.9	574.9	567.7	2,234.5	572.4	597.9	617.5	610.3	2,398.0
Operating profit	69.7	81.9	96.3	91.1	339.0	90.3	97.2	94.6	106.3	388.4	124.1	114.0	112.0	124.2	474.3
Recurring profit	75.3	81.0	80.4	90.4	327.1	88.4	86.5	94.5	110.4	379.9	124.1	114.0	112.1	124.2	474.4
Income tax	17.9	21.3	20.3	22.5	82.1	22.4	20.2	22.1	30.3	95.0	31.0	28.5	28.0	31.1	118.6
Tax rate (%)		23.8	26.3	25.3	24.9	25.1	25.3	23.4	23.4	27.4	25.0	25.0	25.0	25.0	25.0
Net profit	57.4	59.7	60.1	67.9	245.1	66.1	66.3	72.4	80.1	284.9	93.1	85.5	84.0	93.2	355.8
Chg (YoY)															
Sales	6.2	13.7	4.7	0.9	6.3	5.4	0.1	8.4	8.3	5.5	7.0	7.4	7.4	7.5	7.3
Operating profit	7.7	27.7	53.2	165.0	49.9	29.5	18.6	(1.7)	16.7	14.6	37.4	17.3	18.4	16.8	22.1
Recurring profit	21.4	1,724.1	44.5	282.5	124.4	17.4	6.8	17.5	22.1	16.1	40.3	31.8	18.6	12.5	24.9
Net profit	25.0	T/N	40.4	402.6	160.6	15.2	11.0	20.5	18.0	16.2	40.9	29.0	16.1	16.3	24.9
Margins (%)															
Operating margin	13.7	14.7	18.1	17.4	16.0	16.9	17.4	16.5	18.7	17.4	21.7	19.1	18.1	20.4	19.8
Recurring margin		14.8	14.6	15.2	17.3	15.4	16.5	15.5	16.4	19.4	17.0	21.7	19.1	18.1	20.4
Net margin	11.3	10.7	11.3	13.0	11.6	12.4	11.9	12.6	14.1	12.7	16.3	14.3	13.6	15.3	14.8

Source: Coway, Mirae Asset Research

Summary financial statements

Profit & loss

Year end Dec 31 (KRWbn)	2013	2014E	2015E	2016E
Revenue	2,118	2,235	2,398	2,536
Cost of goods sold	721	761	812	864
Gross profit	1,397	1,473	1,586	1,672
SG&A	1,058	1,085	1,111	1,137
EBIT (Adj.)	339	388	474	535
EBIT	339	388	474	535
Net interest income (loss)	(14)	(3)	(2)	1
Income (loss) from associates	0	0	0	0
Others	3	(6)	2	2
Recurring profit	327	380	474	538
Income tax	82	95	119	134
Net profit	245	285	356	403
Net profit (Controlling Interests)	245	285	356	403
EPS (Controlling Interests, KRW)	3,178	3,694	4,613	5,229

Growth & margins (%)	2013	2014E	2015E	2016E
Revenue growth	6.3	5.5	7.3	5.8
Gross profit growth	6.3	5.4	7.6	5.4
EBIT growth	49.9	14.6	22.1	12.7
Net profit growth	160.6	16.2	24.9	13.4
EPS growth	160.6	16.2	24.9	13.4
Gross margin	66.0	65.9	66.1	65.9
EBIT margin	16.0	17.4	19.8	21.1
Net profit margin	11.6	12.7	14.8	15.9

Source: Coway, Mirae Asset Research estimates

Cash flow

Year end Dec 31 (KRWbn)	2013	2014E	2015E	2016E
Cash flow from operations	537	534	578	638
Net profit	245	285	356	403
Depr. & amortization	198	207	223	235
Others	135	48	43	43
Change in working capital	(41)	(6)	(44)	(44)
Cash flow from investing	(74)	(301)	(271)	(271)
Capital expenditures	(268)	(300)	(270)	(270)
Others	194	(1)	(1)	(1)
Cash flow from financing	(373)	(332)	(157)	(213)
Dividends	(78)	(124)	(157)	(213)
Increase in equity	0	0	0	0
Increase in debt	(262)	(208)	0	0
Beginning cash*	156	245	147	296
Ending cash*	245	147	296	449

Source: Coway, Mirae Asset Research estimates

Note: * Including short-term financial assets

Balance sheet

Year end Dec 31 (KRWbn)	2013	2014E	2015E	2016E
Current assets	691	573	754	933
Cash & equivalents	239	112	120	127
Short-term financial asset	6	35	176	323
Accounts receivable	213	213	229	242
Inventory	66	58	62	66
Other current assets	168	155	166	176
Non-current assets	976	1,069	1,117	1,152
Net fixed assets	638	739	794	836
Investments	2	2	2	2
Other long-term assets	336	328	320	313
Total assets	1,668	1,642	1,870	2,085
Current liabilities	677	368	395	418
Accounts payable	37	39	41	44
Short-term debt	328	0	0	0
Other current liabilities	312	329	353	374
Non-current liabilities	50	172	174	176
Long-term debt	0	120	120	120
Other long-term liabilities	50	52	54	56
Total liabilities	727	540	569	594
Controlling Interests	941	1,102	1,301	1,491
Non-Controlling Interests	0	0	0	0
Shareholder's equity	941	1,102	1,301	1,491
BVPS(KRW)	12,200	14,291	16,873	19,334

Source: Coway, Mirae Asset Research estimates

Ratio analysis

Year end Dec 31	2013	2014E	2015E	2016E
ROE (%)	12.3	28.4	27.9	29.6
ROA (%)	14.3	17.2	20.3	20.4
Inventory days	11.8	10.1	9.2	9.2
Receivables days	38.4	34.8	33.6	33.9
Payable days	7.1	6.2	6.1	6.1
Net debt/equity (%)	8.8	(2.4)	(13.6)	(22.1)
Interest cover (x)	23.4	137.2	286.7	(388.7)

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

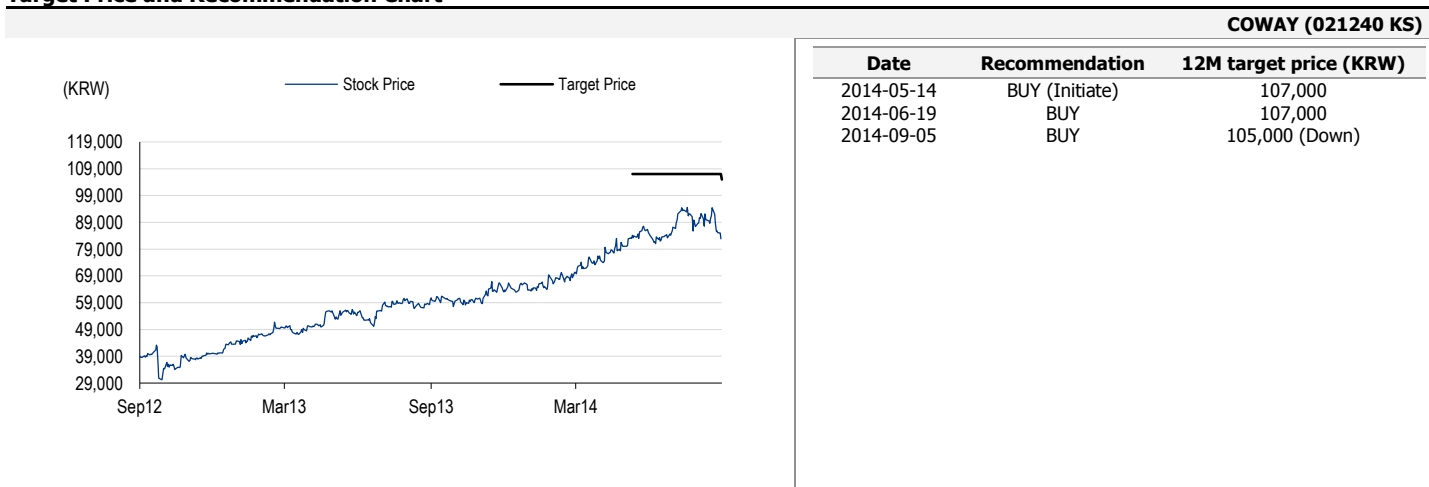
OVERWEIGHT: over +10% of the current industry index
NEUTRAL: -10% to +10% of the current industry index
UNDERWEIGHT: -10% or less than the current industry index

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Target Price and Recommendation Chart



Source: Bloomberg, Mirae Asset Research

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