

Coway (021240)

12M rating **BUY (Maintain)**

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

Up/downside **+24%**

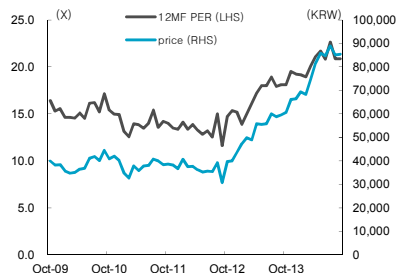
Stock Data

KOSPI (Sep 26, pt)	2,032
Stock price (Sep 26, KRW)	85,400
Market cap (USD mn)	6,306
Shares outstanding (mn)	77
52-Week high/low (KRW)	94,600/57,500
6M avg. daily turnover (USD mn)	16.8
Free float / Foreign ownership (%)	65.3/54.6
Major shareholders (%)	
Coway Holdings, Inc. and 11 others	31.0

Performance

	1M	6M	12M
Absolute (%)	(3.8)	15.9	42.6
Relative to KOSPI (%p)	(2.1)	12.4	41.4

12MF PE trend



Source: WISEfn consensus

3Q14 preview: Rental account growth to be catalyst

Core rental growth to rebound, earnings to continue improving

We estimate 3Q14 separate sales at W508.3bn, up 4% YoY, and OP at W98.4bn, up 1% YoY. OPM should remain relatively flat at 19.4%, versus 19.8% in 2013. Sales should fall slightly short of consensus while OP should be in line. Top-line growth should be weak on a high 3Q13 base as exports surged 90% YoY. But, exports, mainly driven by ODM, should resume growing as buyers finished sell-through. We believe the leading player should continue to expand on a rapid growth in air purifiers and low penetration in China. And, core rental sales (80% of sales) appear to be in recovery, and should fuel top-line growth from 4Q14. We expect OP in line with the consensus as sales improve in rentals rather than lump sum payments, lowering the commission burden, and as SG&A expenses stabilize.

Account growth to be catalyst, water and air purifiers and mattresses continue improving

Rental sales and account growth should lead to top-line growth in 4Q14 and 2015. While rental sales growth reached only 4.5% in 1H14, growth should pick up to 6.3% in 2H14. On an annual basis, we forecast rental sales will grow 5.1% in 2014 and 7.6% in 2015, up from 4.5% in 2013, backed by rental account expansion. And, the number of accounts should increase 3.4% in 3Q14 and 4.6% in 4Q14, after edging up only 0.8% in 1Q14 and 1.8% in 2Q14. Going forward, new sales are expected to climb 26% YoY to 325,000 units, and churn should remain around 1% in 3Q14. We estimate a net increase of 85,000 subscriber accounts, up from 62,000 in 2Q14, and we expect more growth during the peak season in 4Q14. Sales appear solid for air purifiers and mattresses. Water purifier sales rebounded from 2Q14 YoY, and should continue to improve in 3Q14, unlike 2013. Although market share is falling with the emergence of new competitors, such as Cuckoo Electronics, Coway should regain share on new product launches.

Peak season in 4Q14, dividend merit to stand out

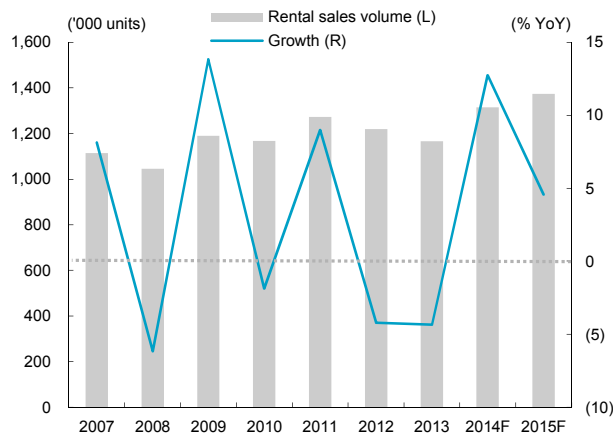
We maintain BUY with a TP of W106,000 (25x 12MF PE). We maintain a positive view given robust growth on increasing demand for domestic environmental home appliances and solid cash flows at the service-based rental business. And, Coway should benefit as its main business recovers and domestic and overseas businesses grow. Meanwhile, dividend yield should reach 2.4% in 2014 and 2.8% in 2015. Of note, peak seasonal momentum and dividend merit will likely 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	385	284	3,824	16.5	576	22.3	11.3	5.6	28.2	2.3
2015F	2,454	435	329	4,433	15.9	627	19.3	10.2	4.9	28.6	2.8
2016F	2,682	495	377	5,071	14.4	688	16.8	9.2	4.4	28.7	3.3

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

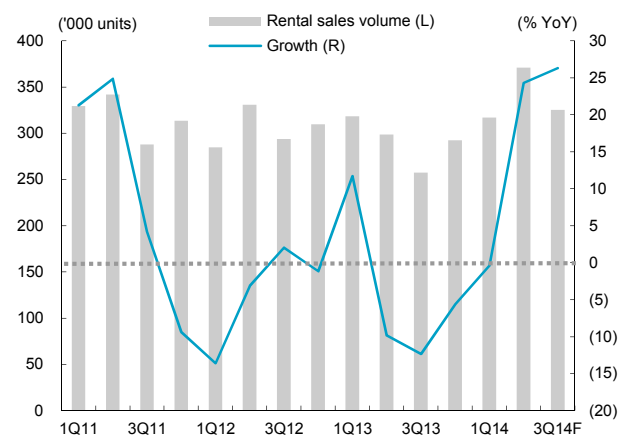
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Figure 1. 2014 new rental sales appear to recover



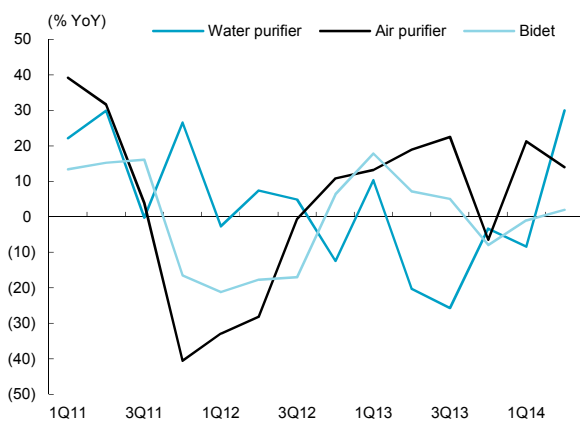
Source: Coway, Korea Investment securities & Investment

Figure 2. 3Q14 rental sales to grow 27% YoY



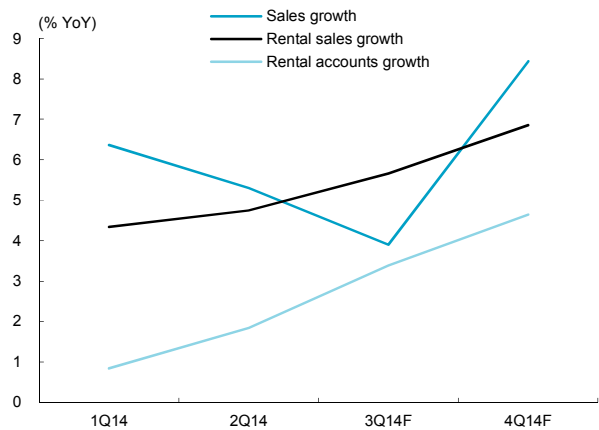
Source: Coway, Korea Investment securities & Investment

Figure 3. Water purifiers sales to rebound



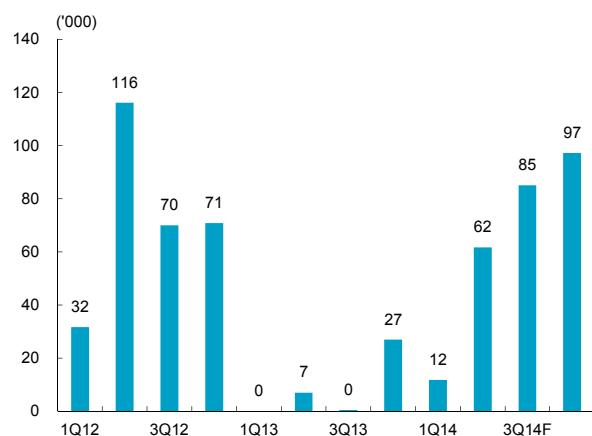
Source: Coway, Korea Investment securities & Investment

Figure 4. Weak 3Q14 sale growth, but rentals to recover



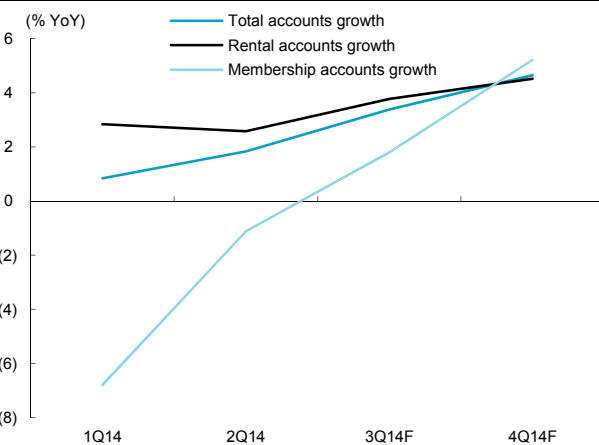
Source: Coway, Korea Investment securities & Investment

Figure 5. Account growth to pick up in 2H14



Source: Coway, Korea Investment securities & Investment

Figure 6. Accounts to grow 3.4% in 3Q14, 4.6% in 4Q14



Source: Coway, 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	3Q14F	4Q14F
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	3.0	2.7
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	13,772	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	332	342
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	65.3	65.4
OP	70	73	73	28	64	65	63	36	69	79	97	88	90	98	98	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	1.4	11.6
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	19.4	18.7

Source: Coway, Korea Investment securities & Investment

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
- 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	618	601	585
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	672	659	649
Controlling interest	785	941	1,077	1,228	1,396
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	1,004	1,155	1,323
Minority interest	0	0	0	0	0
Shareholders' equity	785	941	1,077	1,228	1,396

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	284	329	377
Depreciation	175	191	183	183	183
Amortization	8	8	8	9	9
Net incr. in W/C	(24)	(41)	(34)	(9)	(11)
Others	201	134	2	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

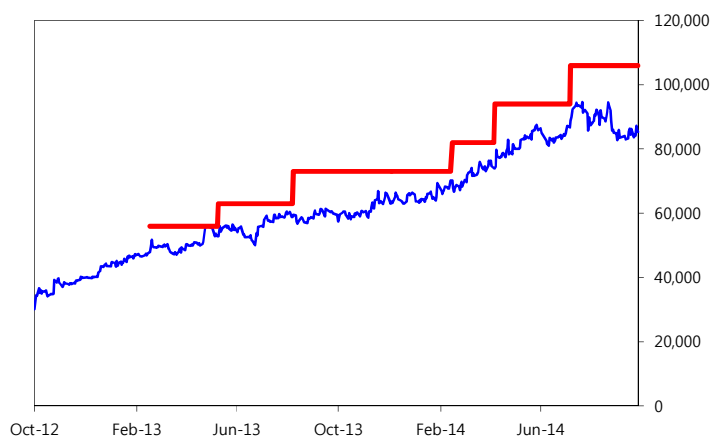
FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Sales	1,993	2,118	2,245	2,454	2,682
COGS	678	721	779	832	898
Gross profit	1,315	1,397	1,466	1,622	1,784
SG&A expense	1,088	1,058	1,081	1,187	1,289
Operating profit	226	339	385	435	495
Financial income	2	4	(1)	7	8
Interest income	2	4	6	7	8
Financial 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	375	434	497
Income taxes	52	82	91	105	120
Net profit	94	245	284	329	377
Net profit of controlling interest	94	245	284	329	377
Other comprehensive profit	5	(1)	0	0	0
Total comprehensive profit	99	244	284	329	377
Total comprehensive profit of controlling interest	99	244	284	329	377
EBITDA	410	537	576	627	688

Key financial data

FY-ending Dec.	2012A	2013A	2014F	2015F	2016F
per share data (KRW)					
EPS	1,267	3,283	3,824	4,433	5,071
BPS	11,354	13,535	15,296	17,253	19,441
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	13.6	13.0	13.7
NP growth	(43.7)	160.6	16.0	15.8	14.4
EPS growth	(43.3)	159.1	16.5	15.9	14.4
EBITDA growth	3.9	31.1	7.3	8.8	9.7
Profitability (%)					
OP margin	11.3	16.0	17.2	17.7	18.5
NP margin	4.7	11.6	12.7	13.4	14.0
EBITDA margin	20.6	25.4	25.7	25.6	25.6
ROA	5.6	14.3	16.6	18.1	19.2
ROE	12.3	28.4	28.2	28.6	28.7
Dividend yield	-	4.1	2.3	2.8	3.3
Dividend payout ratio	0.0	82.4	52.5	54.1	55.2
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	22.3	19.3	16.8
PB	3.8	4.9	5.6	4.9	4.4
EV/EBITDA	9.0	9.5	11.3	10.2	9.2

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Coway (021240)	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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- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of -15% or less
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- 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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Prepared by: Eun-chaе Na

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