

Earnings review

Korea / Consumer

24 October 2014

**BUY**

Target price **KRW105,000**

Last price (23 Oct 2014) **KRW89,600**

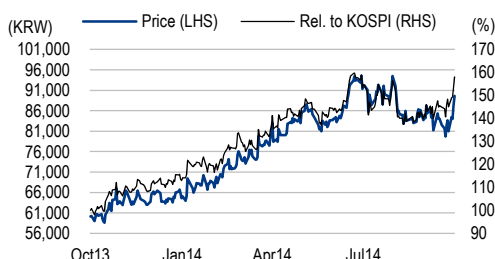
Upside/downside (%)	17.2
KOSPI	1,931.65
Mkt. cap (KRW bn/USD bn)	6,910/6.6
52-week range (KRW)	58,600 - 94,600
Avg. trading value daily (KRW bn)	16.48
Foreign ownership (%)	54.8

Source: Bloomberg

**Forecast earnings & valuation**

Fiscal year ending	Dec-13	Dec-14 E	Dec-15 E	Dec-16 E
<b>Revenue (KRW bn)</b>	<b>2,118</b>	<b>2,235</b>	<b>2,398</b>	<b>2,536</b>
EBIT (KRW bn)	339.0	388.4	474.3	534.6
<b>Net profit (KRW bn)</b>	<b>245.1</b>	<b>284.9</b>	<b>355.8</b>	<b>403.3</b>
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
<b>P/E (x)</b>	<b>20.9</b>	<b>24.3</b>	<b>19.4</b>	<b>17.1</b>
EV/EBITDA (x)	9.7	11.6	9.7	8.6
Dividend yield (%)	2.5	2.3	3.2	3.9
P/B (x)	5.4	6.3	5.3	4.6
<b>ROE (%)</b>	<b>12.3</b>	<b>28.4</b>	<b>27.9</b>	<b>29.6</b>
Net debt/equity (%)	8.8	(2.4)	(13.6)	(22.1)

**Performance**



Performance	1M	3M	12M
Absolute (%)	6.0	(2.0)	50.6
Absolute (USD, %)	4.7	(4.7)	51.7
Relative to KOSPI (%)	10.8	2.8	55.7

Source: Bloomberg

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# COWAY (021240 KS)

## Weak 3Q, better 4Q

Coway has reported inline weak 3Q14 results. We expect the company's earnings growth to resume from 4Q and think the company's healthy earnings growth and improving cash management, via higher cash returns to shareholders, should provide positive sentiment on Coway's shares. We maintain our BUY rating and target price of KRW105,000.

### Weak 3Q operating profit...

During market hours on 24 October, Coway reported weak inline 3Q14 consolidated results. Sales, operating profit and net profit came in at KRW526bn (-1% YoY), KRW95.3bn (-1% YoY) and KRW63.9bn (+6.3% YoY), respectively, with operating profit coming in line with the consensus estimates.

### ...but growth to resume from 4Q

We attribute the weak 3Q14 operating profit to: 1) slower exports (-13% YoY, 6.7% of sales) and outright health equipment sales (-10% YoY, 6.4% of sales); and 2) higher sales commission expenses (+40% YoY, 6.3% of sales), along with new product launches. 3Q14 net profit came in at KRW63.9bn (+6.4% YoY), missing consensus estimates by 11%; however, this is mainly due to KRW2.6bn of non-cash forex-related losses. Normalizing for this, 3Q14 net profit would be in line with the consensus estimates. We think YoY operating profit growth should recover from 4Q, along with controlled sales commission expenses and a recovery in exports.

In 3Q14, export sales (ODM and sales to overseas affiliates) remained weak, at KRW33bn (-13% YoY), partly due to weak ODM sales, especially to China. Management attributed the weak ODM sales to China to inventory adjustments by its local dealers in 3Q. As the investment adjustments are to be completed in 3Q14, management expects its ODM exports to China to recover from 4Q14.

Lastly, the overall competitive landscape in the core rental business has remained soft in 3Q, with growth in Coway's new rental contracts of over 21% YoY, helped by new rental products and strengthened marketing activities.

### 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 and target price of KRW105,000

The stock is now trading at 19.4x 2015E PER, a slight premium to its five-year historical average; 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 1 Coway's 3Q14 earnings review**

<b>(KRW bn)</b>	<b>3Q14</b>	<b>3Q13</b>	<b>Chg. (%, YoY)</b>	<b>3Q14 (Cons.)</b>	<b>Diff. (%)</b>	<b>3Q14E (previous)</b>	<b>Diff. (%)</b>
Sales	525.5	530.5	(0.9)	552.1	(4.8)	574.9	(8.6)
Operating profit	95.3	96.3	(1.0)	96.9	(1.7)	94.6	0.7
OPM (%)	18.1	18.1		17.6		16.5	
Net profit	63.9	60.1	6.4	71.9	(11.1)	72.4	(11.7)
NPM (%)	12.2	11.3		13.0		12.6	

Source: Company data, Bloomberg, Mirae Asset Research

**Figure 2 Quarterly earnings estimates**

<b>(KRW bn)</b>	<b>1Q13</b>	<b>2Q13</b>	<b>3Q13</b>	<b>4Q13</b>	<b>2013</b>	<b>1Q14</b>	<b>2Q14</b>	<b>3Q14E*</b>	<b>4Q14E</b>	<b>2014E</b>	<b>1Q15E</b>	<b>2Q15E</b>	<b>3Q15E</b>	<b>4Q15E</b>	<b>2015E</b>
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	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
<b>Chg (% YoY)</b>															
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
<b>Margins (%)</b>															
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	14.8	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

Note: \* 3Q14 figures are based on Mirae Asset Research estimate

## Summary financial statements

### Profit & loss

Year end Dec 31 (KRW bn)	2013	2014E	2015E	2016E
<b>Revenue</b>	<b>2,118</b>	<b>2,235</b>	<b>2,398</b>	<b>2,536</b>
Cost of goods sold	721	761	812	864
<b>Gross profit</b>	<b>1,397</b>	<b>1,473</b>	<b>1,586</b>	<b>1,672</b>
SG&A	1,058	1,085	1,111	1,137
<b>EBIT (Adj.)</b>	<b>339</b>	<b>388</b>	<b>474</b>	<b>535</b>
<b>EBIT</b>	<b>339</b>	<b>388</b>	<b>474</b>	<b>535</b>
Net interest income (loss)	(14)	(3)	(2)	1
Income (loss) from associates	0	0	0	0
Others	3	(6)	2	2
<b>Recurring profit</b>	<b>327</b>	<b>380</b>	<b>474</b>	<b>538</b>
Income tax	82	95	119	134
<b>Net profit</b>	<b>245</b>	<b>285</b>	<b>356</b>	<b>403</b>
<b>Net profit (Controlling Interests)</b>	<b>245</b>	<b>285</b>	<b>356</b>	<b>403</b>
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 (KRW bn)	2013	2014E	2015E	2016E
<b>Cash flow from operations</b>	<b>537</b>	<b>534</b>	<b>578</b>	<b>638</b>
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)
<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>(157)</b>	<b>(213)</b>
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

Note: \* Including short-term financial asset  
Source: Coway, Mirae Asset Research estimates

### Balance sheet

Year end Dec 31 (KRW bn)	2013	2014E	2015E	2016E
<b>Current assets</b>	<b>691</b>	<b>573</b>	<b>754</b>	<b>933</b>
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
<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>1,642</b>	<b>1,870</b>	<b>2,085</b>
<b>Current liabilities</b>	<b>677</b>	<b>368</b>	<b>395</b>	<b>418</b>
Accounts payable	37	39	41	44
Short-term debt	328	0	0	0
Other current liabilities	312	329	353	374
<b>Non-current liabilities</b>	<b>50</b>	<b>172</b>	<b>174</b>	<b>176</b>
Long-term debt	0	120	120	120
Other long-term liabilities	50	52	54	56
<b>Total liabilities</b>	<b>727</b>	<b>540</b>	<b>569</b>	<b>594</b>
Controlling Interests	941	1,102	1,301	1,491
Non-Controlling Interests	0	0	0	0
<b>Shareholder's equity</b>	<b>941</b>	<b>1,102</b>	<b>1,301</b>	<b>1,491</b>
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

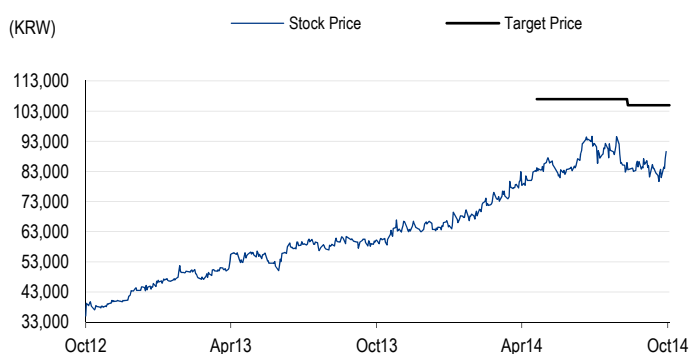
NEUTRAL: -10% to +10% of the current industry index

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

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			Number of Shares	Purchase Price	Purchase Date				
<b>REMARK: Korean analyst is responsible for Korean securities and relevant sectors only.</b>									

**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
2014-09-05	BUY	105,000 (Down)
2014-10-24	BUY	105,000

Source: Bloomberg, Mirae Asset Research

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