

Coway

(021240 KS)

Earnings quality continues to improve

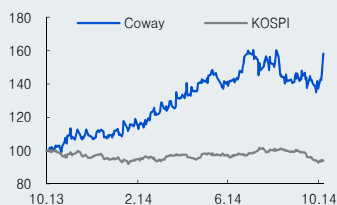
Consumer Services

Results Comment
October 27, 2014

| | |
|---------------------------|----------------|
| (Maintain) | Buy |
| Target Price (12M, W) | 120,000 |
| Share Price (10/24/14, W) | 93,300 |
| Expected Return | 29% |

| | |
|----------------------------|----------|
| OP (14F, Wbn) | 373 |
| Consensus OP (14F, Wbn) | 384 |
| EPS Growth (14F, %) | 5.4 |
| Market EPS Growth (14F, %) | 5.4 |
| P/E (14F, x) | 27.9 |
| Market P/E (14F, x) | 11.9 |
| KOSPI | 1,925.69 |
| Market Cap (Wbn) | 7,196 |
| Shares Outstanding (mn) | 77 |
| Free Float (%) | 65.1 |
| Foreign Ownership (%) | 55.0 |
| Beta (12M) | 0.50 |
| 52-Week Low | 58,600 |
| 52-Week High | 94,600 |

| (%) | 1M | 6M | 12M |
|----------|------|------|------|
| Absolute | 10.8 | 12.5 | 55.2 |
| Relative | 17.1 | 16.8 | 65.0 |



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[Hotel/Leisure, Cosmetics, Fashion]

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3Q review: Profitability remains high at 19.6%

For 3Q, Coway announced non-consolidated preliminary revenue of W496.1bn (+1.4% YoY) and operating profit of W97bn (flat YoY; OP margin of 19.6%). Revenue was slightly lower than expected, but margin once again surprised to the upside. We largely attribute the revenue miss to sluggish lump-sum payment sales of environmental home appliances, which fell 10.4% YoY as a result of much weaker-than-expected dehumidifier sales amid drier-than-usual weather.

However, key indicators of earnings quality and long-term growth remained strong. 3Q new rental accounts jumped 20.7% YoY to 311,000, bringing 2014 cumulative new accounts to a record-high 999,000 (80% of annual target). Home care revenue surged 57.8% YoY on robust mattress sales, while cosmetics revenue eked out a 3.6% YoY increase despite unfavorable seasonality.

Proving its superior cost control yet again

After focusing on improving profitability in 2013, Coway has shifted its focus on driving top-line growth through new rental accounts. The company has been successful so far, growing average quarterly new rental accounts to a record 330,000 YTD.

For a rental business, the inflow of new orders is key to sustainable growth. However, strong orders squeeze margins in the near term because income is spread out across the rental period, whereas SG&A expenses (commissions, etc.) are incurred all at once.

Indeed, Coway's 3Q SG&A expense ratio rose 2.3%p YoY, in line with our projection. However, cost ratio improved 2%p during the same period, supported by strong sales of new products and cost-saving efforts. As a result, overall OP margin again beat our expectations, once again underscoring the company's superior cost control.

Reiterate Buy and Raise TP by 7% to W120,000

Key quality indicators of Coway's core rental business have continued to improve. Churn rate fell back to a record-low 0.96% in 3Q, after inching up QoQ in 2Q following the expiry of a large number of accounts subscribed in 2011 (as part of a promotional event). The rental asset disposal ratio also remained steady at a historically low 2.9%.

The growth of Coway's rental earnings and new accounts raises confidence in the company's long-term prospects. We maintain our Buy call on the stock and lift our target price by 7% to W120,000, reflecting modest upward revisions to our earnings forecasts from 2016 onwards.

| FY (Dec) | 12/11 | 12/12 | 12/13 | 12/14F | 12/15F | 12/16F |
|---------------|-------|-------|-------|--------|--------|--------|
| Revenue (Wbn) | 1,824 | 1,993 | 2,118 | 2,171 | 2,354 | 2,541 |
| OP (Wbn) | 235 | 226 | 339 | 373 | 426 | 484 |
| OP margin (%) | 12.9 | 11.3 | 16.0 | 17.2 | 18.1 | 19.0 |
| NP (Wbn) | 167 | 94 | 245 | 258 | 295 | 346 |
| EPS (W) | 2,166 | 1,219 | 3,178 | 3,348 | 3,827 | 4,489 |
| ROE (%) | 22.2 | 12.3 | 28.4 | 25.9 | 26.0 | 26.3 |
| P/E (x) | 16.9 | 35.7 | 20.9 | 27.9 | 24.4 | 20.8 |
| P/B (x) | 3.3 | 3.8 | 4.9 | 6.1 | 5.4 | 4.7 |

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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Table 1. 3Q14P earnings results (non-consolidated K-IFRS) (Wbn, %)

| | 3Q13 | 2Q14 | 3Q14P | | | Growth | |
|------------------|------|------|-------------|------------|-----------|--------|------|
| | | | Preliminary | KDB Daewoo | Consensus | YoY | QoQ |
| Revenue | 489 | 523 | 496 | 532 | 519 | 1.4 | -5.2 |
| Operating profit | 97 | 98 | 97 | 91 | 99 | 0.0 | -0.6 |
| OP margin (%) | 19.8 | 18.7 | 19.6 | 17.2 | 19.1 | | |
| Pretax profit | 83 | 87 | 88 | 89 | 96 | 6.2 | 1.7 |
| Net profit | 62 | 65 | 66 | 67 | 71 | 6.7 | 1.8 |

Source: Company data, KDB Daewoo Securities Research estimates

Table 2. 3Q14P consolidated results (Wbn, %)

| | 3Q13 | 2Q14 | 3Q14P | | | Growth | |
|------------------|------|------|-------------|------------|-----------|--------|------|
| | | | Preliminary | KDB Daewoo | Consensus | YoY | QoQ |
| Revenue | 531 | 557 | 526 | 568 | 552 | -0.9 | -5.6 |
| Operating profit | 96 | 97 | 95 | 95 | 97 | -1.0 | -1.9 |
| OP margin (%) | 18.1 | 17.4 | 18.1 | 16.7 | 17.6 | | |
| Pretax profit | 80 | 87 | 86 | 86 | 90 | 6.8 | -0.7 |
| Net profit | 60 | 66 | 64 | 65 | 68 | 6.3 | -3.6 |

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 | 2,223 | 2,419 | 2,171 | 2,354 | -2.4 | |
| Operating profit | 377 | 432 | 373 | 426 | -1.1 | -1.4 | |
| Pretax profit | 354 | 412 | 342 | 391 | -3.3 | -5.2 | - Revised down F/X-translation losses |
| Net profit | 267 | 311 | 258 | 295 | -3.3 | -5.1 | |

Notes: Consolidated K-IFRS. Source: Company data, KDB Daewoo Securities Research estimates

Table 4. Quarterly consolidated earnings trends (Wbn, %)

| | 1Q13 | 2Q13 | 3Q13 | 4Q13 | 1Q14 | 2Q14 | 3Q14P | 4Q14F |
|------------------------------|------|------|------|------|------|------|-------|-------|
| Revenue | 507 | 556 | 531 | 524 | 535 | 557 | 526 | 554 |
| Operating profit | 70 | 82 | 96 | 91 | 90 | 97 | 95 | 90 |
| OP margin (%) | 13.7 | 14.7 | 18.1 | 17.4 | 16.9 | 17.4 | 18.1 | 16.2 |
| Net profit | 57 | 60 | 60 | 68 | 66 | 66 | 65 | 61 |
| Net margin (%) | 11 | 11 | 11 | 13 | 12 | 12 | 12 | 11 |
| Rental asset disposal losses | 12 | 10 | 9 | 8 | 10 | 11 | 10 | 10 |
| (%, revenue) | 3.5 | 3.0 | 2.8 | 2.4 | 2.8 | 3.1 | 2.9 | 2.9 |

Source: Company data, KDB Daewoo Securities Research estimates

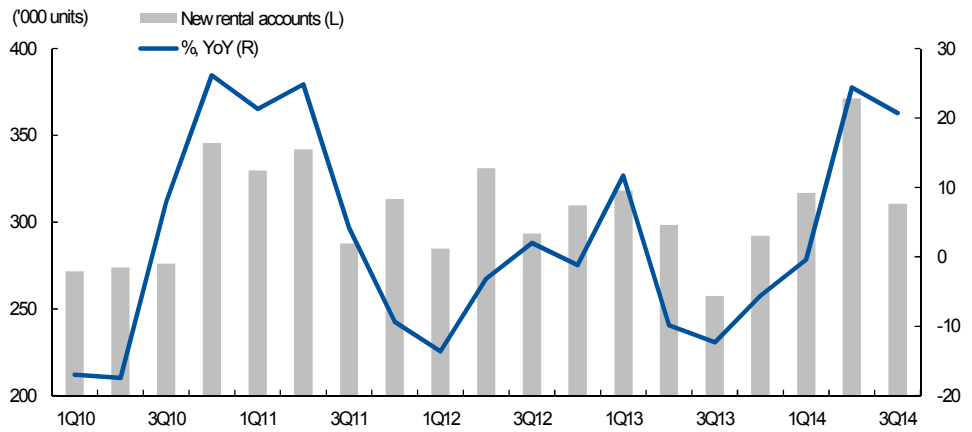
Table 5. DCF valuation

(Wbn, %, '000 shares)

| | 14F | 15F | 16F | 17F | 18F |
|--------------------------------|--------|----------------|-----|-----|-----|
| EBIT | 373 | 426 | 484 | 495 | 505 |
| - Taxes | 91 | 104 | 118 | 121 | 123 |
| - Capex | 280 | 281 | 292 | 298 | 304 |
| - Chg. in working capital | 46 | 40 | 36 | 36 | 37 |
| + Depreciation | 187 | 184 | 195 | 199 | 203 |
| + Amortization | 8 | 8 | 8 | 8 | 8 |
| + Rental asset disposal losses | 41 | 44 | 46 | 47 | 47 |
| FCFF | 192 | 236 | 287 | 293 | 299 |
| Final year FCFF | 279 | | | | |
| Terminal value | 10,329 | | | | |
| Terminal growth | 2% | | | | |
| NPV of FCFF | | 1,189 | | | |
| PV of terminal value | | 8,135 | | | |
| Enterprise value | | 9,324 | | | |
| Cash & equivalents | | 225 | | | |
| Other investment | | 6 | | | |
| Interest-bearing debt | | 277 | | | |
| Minority interests | | 0 | | | |
| Preferred shares | | 0 | | | |
| Current equity value | | 9,278 | | | |
| Shares outstanding | | 77,125 | | | |
| Target price (W) | | 120,000 | | | |
| Current price (W) | | 93,300 | | | |
| Upside (%) | | 28.6% | | | |

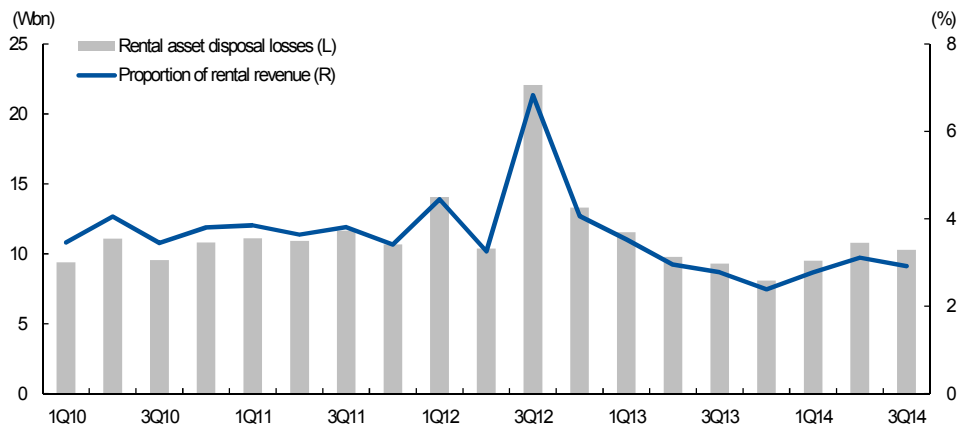
Source: Company data, KDB Daewoo Securities Research estimates

Chart 1. New rental accounts maintaining strength



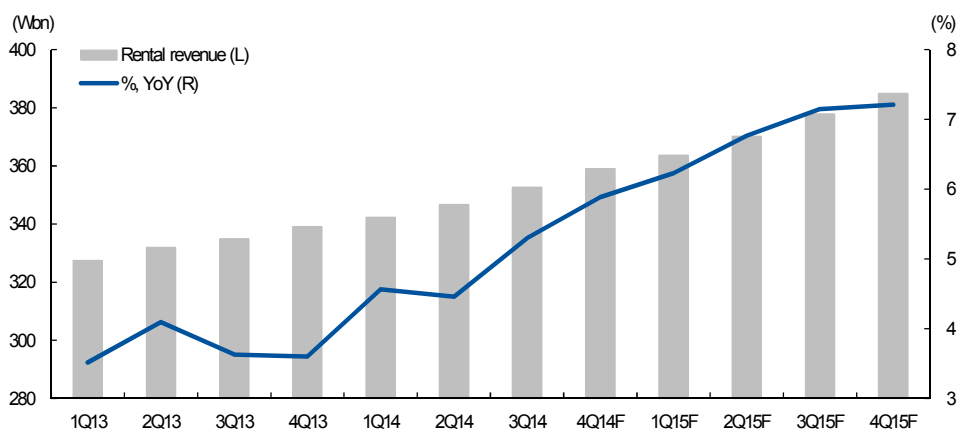
Source: Company data, KDB Daewoo Research

Chart 2. Quarterly rental asset disposal losses & proportion of rental revenue trend



Source: Company data, KDB Daewoo Research

Chart 3. Quarterly rental revenue trend & forecast



Source: Company data, KDB Daewoo Research

Coway (021240 KS/Buy/TP: W120,000)

Comprehensive Income Statement (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Revenue | 2,118 | 2,171 | 2,354 | 2,541 |
| Cost of Sales | 721 | 719 | 774 | 842 |
| Gross Profit | 1,397 | 1,452 | 1,580 | 1,699 |
| SG&A Expenses | 1,058 | 1,079 | 1,154 | 1,214 |
| Operating Profit (Adj) | 339 | 373 | 426 | 484 |
| Operating Profit | 339 | 373 | 426 | 484 |
| Non-Operating Profit | -12 | -31 | -35 | -26 |
| Net Financial Income | -14 | -10 | -10 | -8 |
| Net Gain from Inv in Associates | 18 | 0 | 0 | 0 |
| Pretax Profit | 327 | 342 | 391 | 458 |
| Income Tax | 82 | 84 | 95 | 112 |
| Profit from Continuing Operations | 245 | 258 | 295 | 346 |
| Profit from Discontinued Operations | 0 | 0 | 0 | 0 |
| Net Profit | 245 | 258 | 295 | 346 |
| Controlling Interests | 245 | 258 | 295 | 346 |
| Non-Controlling Interests | 0 | 0 | 0 | 0 |
| Total Comprehensive Profit | 244 | 247 | 295 | 346 |
| Controlling Interests | 244 | 247 | 295 | 346 |
| Non-Controlling Interests | 0 | 0 | 0 | 0 |
| EBITDA | 537 | 568 | 618 | 686 |
| FCF (Free Cash Flow) | 269 | 187 | 188 | 244 |
| EBITDA Margin (%) | 25.4 | 26.2 | 26.3 | 27.0 |
| Operating Profit Margin (%) | 16.0 | 17.2 | 18.1 | 19.0 |
| Net Profit Margin (%) | 11.6 | 11.9 | 12.5 | 13.6 |

Statement of Financial Condition (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|----------------------------------|--------------|--------------|--------------|--------------|
| Current Assets | 691 | 691 | 795 | 929 |
| Cash and Cash Equivalents | 239 | 225 | 297 | 401 |
| AR & Other Receivables | 227 | 228 | 245 | 262 |
| Inventories | 66 | 72 | 77 | 82 |
| Other Current Assets | 159 | 166 | 176 | 184 |
| Non-Current Assets | 976 | 1,017 | 1,068 | 1,117 |
| Investments in Associates | 0 | 0 | 0 | 0 |
| Property, Plant and Equipment | 638 | 669 | 722 | 773 |
| Intangible Assets | 177 | 173 | 166 | 159 |
| Total Assets | 1,668 | 1,709 | 1,863 | 2,046 |
| Current Liabilities | 677 | 578 | 560 | 536 |
| AP & Other Payables | 191 | 187 | 202 | 216 |
| Short-Term Financial Liabilities | 335 | 269 | 260 | 240 |
| Other Current Liabilities | 151 | 122 | 98 | 80 |
| Non-Current Liabilities | 50 | 78 | 85 | 94 |
| Long-Term Financial Liabilities | 0 | 9 | 9 | 9 |
| Other Non-Current Liabilities | 50 | 69 | 76 | 85 |
| Total Liabilities | 727 | 656 | 645 | 630 |
| Controlling Interests | 941 | 1,051 | 1,217 | 1,415 |
| Capital Stock | 41 | 41 | 41 | 41 |
| Capital Surplus | 126 | 126 | 126 | 126 |
| Retained Earnings | 868 | 993 | 1,158 | 1,356 |
| Non-Controlling Interests | 0 | 1 | 1 | 1 |
| Stockholders' Equity | 941 | 1,052 | 1,218 | 1,416 |

Cash Flows (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|--------------------------------|------------|-------------|------------|-------------|
| Cash Flows from Op Activities | 537 | 466 | 469 | 535 |
| Net Profit | 245 | 258 | 295 | 346 |
| Non-Cash Income and Expense | 374 | 344 | 302 | 328 |
| Depreciation | 191 | 187 | 184 | 195 |
| Amortization | 8 | 8 | 7 | 7 |
| Others | 175 | 149 | 111 | 126 |
| Chg in Working Capital | -41 | -33 | -33 | -27 |
| Chg in AR & Other Receivables | 67 | -12 | -17 | -16 |
| Chg in Inventories | 19 | -8 | -6 | -5 |
| Chg in AP & Other Payables | -82 | 3 | 3 | 3 |
| Income Tax Paid | -41 | -103 | -95 | -112 |
| Cash Flows from Inv Activities | -76 | -264 | -247 | -253 |
| Chg in PP&E | -258 | -253 | -238 | -246 |
| Chg in Intangible Assets | -2 | 0 | 0 | 0 |
| Chg in Financial Assets | -4 | -3 | -5 | -4 |
| Others | 188 | -8 | -4 | -3 |
| Cash Flows from Fin Activities | -373 | -214 | -151 | -179 |
| Chg in Financial Liabilities | -260 | -57 | -9 | -19 |
| Chg in Equity | 0 | 0 | 0 | 0 |
| Dividends Paid | -78 | -124 | -130 | -148 |
| Others | -35 | -33 | -12 | -12 |
| Increase (Decrease) in Cash | 86 | -13 | 72 | 104 |
| Beginning Balance | 152 | 239 | 225 | 297 |
| Ending Balance | 239 | 225 | 297 | 401 |

Source: Company data, KDB Daewoo Securities Research estimates

Forecasts/Valuations (Summarized)

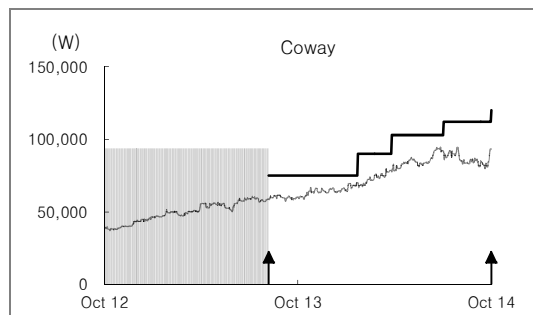
| | 12/13 | 12/14F | 12/15F | 12/16F |
|----------------------------------|--------|--------|--------|--------|
| P/E (x) | 20.9 | 27.9 | 24.4 | 20.8 |
| P/CF (x) | 8.3 | 12.0 | 12.0 | 10.7 |
| P/B (x) | 4.9 | 6.1 | 5.4 | 4.7 |
| EV/EBITDA (x) | 9.7 | 12.8 | 11.6 | 10.3 |
| EPS (W) | 3,178 | 3,348 | 3,827 | 4,489 |
| CFPS (W) | 8,030 | 7,807 | 7,748 | 8,739 |
| BPS (W) | 13,535 | 15,172 | 17,317 | 19,884 |
| DPS (W) | 2,710 | 1,749 | 1,999 | 2,345 |
| Payout ratio (%) | 82.4 | 50.2 | 50.2 | 50.2 |
| Dividend Yield (%) | 4.1 | 1.9 | 2.1 | 2.5 |
| Revenue Growth (%) | 6.3 | 2.5 | 8.4 | 7.9 |
| EBITDA Growth (%) | 31.0 | 5.8 | 8.8 | 11.0 |
| Operating Profit Growth (%) | 50.0 | 10.0 | 14.2 | 13.6 |
| EPS Growth (%) | 160.7 | 5.3 | 14.3 | 17.3 |
| Accounts Receivable Turnover (x) | 9.5 | 10.2 | 10.6 | 10.7 |
| Inventory Turnover (x) | 30.8 | 31.6 | 31.6 | 31.8 |
| Accounts Payable Turnover (x) | 17.4 | 19.8 | 20.7 | 21.0 |
| ROA (%) | 14.3 | 15.3 | 16.5 | 17.7 |
| ROE (%) | 28.4 | 25.9 | 26.0 | 26.3 |
| ROIC (%) | 23.0 | 26.9 | 28.5 | 30.2 |
| Liability to Equity Ratio (%) | 77.3 | 62.4 | 53.0 | 44.5 |
| Current Ratio (%) | 102.2 | 119.6 | 142.0 | 173.5 |
| Net Debt to Equity Ratio (%) | 9.5 | 4.4 | -2.9 | -11.2 |
| Interest Coverage Ratio (x) | 18.2 | 29.0 | 35.1 | 42.2 |

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

| Company (Code) | Date | Rating | Target Price |
|----------------|------------|-------------|--------------|
| Coway(O21240) | 10/26/2014 | Buy | 120,000 |
| | 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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