

Coway (021240)

Above

In line

Below

12M rating **BUY (Maintain)**

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

Up/downside **+14%**

Stock Data

| | |
|------------------------------------|---------------|
| KOSPI (Oct 24, pt) | 1,926 |
| Stock price (Oct 24, KRW) | 93,300 |
| Market cap (USD mn) | 6,804 |
| Shares outstanding (mn) | 77 |
| 52-Week high/low (KRW) | 94,600/58,600 |
| 6M avg. daily turnover (USD mn) | 16.2 |
| Free float / Foreign ownership (%) | 65.1/55.0 |
| Major shareholders (%) | |
| Coway Holdings Inc. and 11 others | 31.0 |

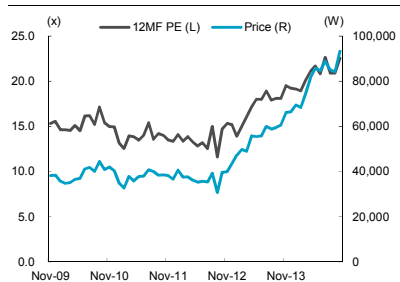
Valuation

| | 2013A | 2014F | 2015F |
|---------------|--------|--------|--------|
| PE (x) | 20.2 | 25.7 | 21.3 |
| PB (x) | 4.9 | 6.2 | 5.5 |
| ROE (%) | 28.4 | 26.9 | 28.6 |
| EV/EBITDA (x) | 9.5 | 12.4 | 11.3 |
| EPS (KRW) | 3,283 | 3,629 | 4,375 |
| BPS (KRW) | 13,535 | 15,109 | 17,008 |

Performance

| | 1M | 6M | 12M |
|------------------------|------|------|------|
| Absolute (%) | 10.8 | 12.5 | 55.2 |
| Relative to KOSPI (%p) | 16.2 | 16.2 | 61.2 |

12MF PE trend



Source: WISEfn consensus

Fared well in 3Q14; Recovery and dividend in 4Q14

What's new: Slow non-core business; Overall good earnings visibility

3Q14 separate sales grew only 1.4% YoY but OP met our expectation at W97bn (OPM 19.5%). While Coway achieved the fattest quarterly profitability in 3Q13 on reduced commission costs due to slowed new sales, the margin remained solid in 3Q14 despite brisk new sales. EBT fell short of the expectation. But excluding one-offs such as FX-related losses, it was on par with our estimate. Rental sales that account for ~80% of revenue climbed 5.7% YoY but lump-sum payment (outright purchase) and exports shrank 10% and 13%, respectively, from a year ago. This led to weak top-line growth. YoY cosmetics sales growth was also limited to 3.9%.

Pros: Gradual rise of rental sales value on brisk volume

Bottoming at the 3% level in 2013, the rental sales value is picking up on new subscribers in 2014 and mounting ARPU. At end-3Q14, rental accounts totaled 5.603mn (+2.3% YoY) and ARPU was up 3.5%. In 2014, favorable sales volume is driving net accounts growth. In 3Q14, the rental sales volume added +21% YoY, total accounts net grew 28,000 QoQ and high ARPU rental accounts net increased 51,000 QoQ. In the same quarter, cancellations dropped QoQ to 0.95%/month. The division sold 30% YoY more new water purifiers and 82% YoY more mattresses. Water purifiers are the flagship item (~50% of annual sales volume), and its market share is picking up supported by new product effects and wider distribution channels. With new products accounting for 8%+ of the sales volume, mattresses contribute to the total new sales volume and net accounts growth. Since monthly ARPU is higher for water purifiers and mattresses than air purifiers and bidets, they also allow for a better product mix.

Cons: Sales growth was the slowest of late, but to pick up in 4Q14

Coway's 3Q14 sales growth was the slowest of late. But sales and OP should grow 8% YoY and 14% YoY, respectively, in 4Q14F on rental customer additions and recovery at non-rental businesses. New sales should grow and net subscriber additions accelerate from 3Q14 given seasonally strong demand for purifiers and bidets in the fourth quarter of a year. After a sluggish 3Q14, exports should pick up as orders recover and cosmetics sales grow as trademark disputes are resolved. Poor lump-sum payment sales in 3Q14 were attributed mainly to dehumidifiers but the company's overall revenue did not change substantially thanks to its large sales dependence on rental accounts, which we view as encouraging.

(W bn, %, %p)

| | 3Q14P | | | | Change | | 2014F | |
|-----------|----------|--------|-------|-----------|--------|-------|-------|-----------|
| | KIS est. | Actual | Diff. | Consensus | QoQ | YoY | KIS | Consensus |
| Sales | 508 | 496 | (2.4) | 520 | (5.2) | 1.4 | 2,229 | 2,233 |
| OP | 98 | 97 | (1.3) | 99 | (0.7) | (0.0) | 382 | 384 |
| OP margin | 19.3 | 19.5 | 0.2 | 19.0 | 0.9 | (0.3) | 17.7 | 17.2 |
| EBT | 97 | 88 | (8.7) | 96 | 1.7 | 6.2 | 356 | 380 |
| NP | 73 | 66 | (9.3) | 73 | 1.8 | 6.6 | 270 | 285 |

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Conclusion: More to be desired but upsides confirmed; Maintain BUY

We maintain BUY on Coway at a TP of W106,000 (25x 2015F PE). The company features many upsides including mounting demand for environmental home appliances, a stable rental business built on customer service, the core business is rejuvenating and there are many growth businesses at a home and abroad. We peg the 2014F dividend yield at 2.1% and 2015F at 2.6%.

Table 1. Coway 3Q14 review (consolidated)

(W bn, %)

| | 3Q14P | | Growth | |
|---------|--------|-----------|--------|-------|
| | Actual | Consensus | QoQ | YoY |
| Sales | 526 | 552 | (5.7) | (0.9) |
| OP | 95 | 97 | (1.8) | (1.0) |
| OPM (%) | 18.1 | 17.6 | 0.7 | (0.0) |
| EBT | 86 | 94 | (1.3) | 6.8 |
| NP | 64 | 70 | (3.2) | 6.3 |

Source: Company data, Korea Investment securities & Investment

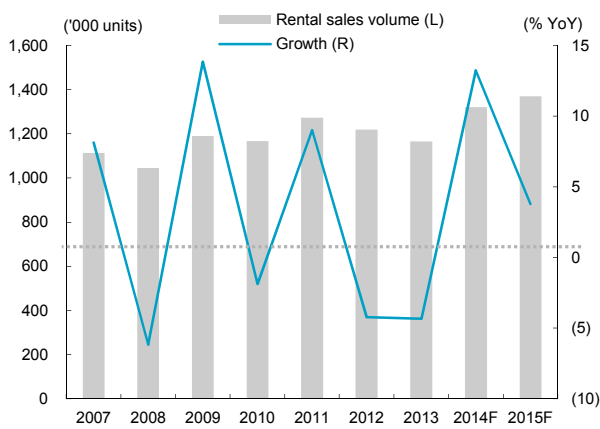
Table 2. Earnings breakdown

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

| | 1Q11 | 2Q11 | 3Q11 | 4Q11 | 1Q12 | 2Q12 | 3Q12 | 4Q12 | 1Q13 | 2Q13 | 3Q13 | 4Q13 | 1Q14 | 2Q14 | 3Q14P | 4Q14F |
|--------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total 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 | 5,603 | 5,694 |
| Accounts increase (QoQ) | 118 | 132 | 78 | 41 | 32 | 116 | 70 | 71 | NM | 7 | 0 | 27 | 12 | 62 | 28 | 92 |
| %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 | 2.3 | 3.5 |
| Rental accounts ('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 | 4,538 | 4,608 |
| Rental accounts increase (QoQ) | 89 | 87 | 55 | 73 | 30 | 38 | 34 | 56 | NA | 43 | 12 | 48 | 20 | 32 | 51 | 71 |
| Membership accounts ('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 | 1,065 | 1,086 |
| Membership accounts increase (QoQ) | 29 | 44 | 23 | (32) | 2 | 78 | 36 | 15 | 2 | (36) | (12) | (21) | (8) | 29 | (22) | 21 |
| New rental sales ('000 units) | 330 | 342 | 288 | 313 | 285 | 331 | 294 | 310 | 318 | 298 | 257 | 292 | 317 | 371 | 311 | 322 |
| New rental sales increase (%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 | 20.8 | 10.1 |
| Cancel 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 (KRW) | 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 | 23,831 | 24,044 |
| 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 | 3.5 | 3.0 |
| Rental ARPU (KRW) | 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 | 26,232 |
| 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 | 3.4 |
| Membership ARPU (KRW) | 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 | 14,742 |
| Membership ARPU (% 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 | 9.2 |
| Rental | 400 | 436 | 430 | 444 | 442 | 446 | 458 | 460 | 465 | 497 | 489 | 482 | 495 | 523 | 496 | 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 | 1.4 | 8.4 |
| Rental | 327 | 340 | 347 | 354 | 356 | 360 | 364 | 370 | 370 | 375 | 378 | 384 | 386 | 392 | 400 | 407 |
| % 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 | 6.0 |
| Lump-sum payment | 32 | 39 | 41 | 32 | 33 | 41 | 39 | 32 | 37 | 48 | 35 | 29 | 28 | 37 | 32 | 32 |
| % 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) | (10.4) | 7.6 |
| Cosmetics | 17 | 18 | 18 | 15 | 17 | 16 | 17 | 17 | 18 | 22 | 17 | 20 | 21 | 22 | 17 | 22 |
| % 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 | 3.6 | 11.6 |
| Exports | 18 | 23 | 25 | 32 | 30 | 21 | 20 | 31 | 32 | 45 | 38 | 31 | 45 | 56 | 33 | 41 |
| % 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 | (13.0) | 34.0 |
| Others | 5 | 17 | 0 | 11 | 7 | 8 | 17 | 11 | 9 | 8 | 21 | 20 | 15 | 15 | 15 | 21 |
| % 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 | (31.1) | 5.7 |
| Gross profit | 274 | 295 | 295 | 294 | 297 | 304 | 306 | 294 | 311 | 329 | 319 | 323 | 326 | 343 | 334 | 343 |
| GP 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 | 67.2 | 65.5 |
| OP | 70 | 73 | 73 | 28 | 64 | 65 | 63 | 36 | 69 | 79 | 97 | 88 | 90 | 98 | 97 | 99 |
| % 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 | (0.0) | 13.5 |
| OP margin (%) | 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 | 19.6 | 19.0 |

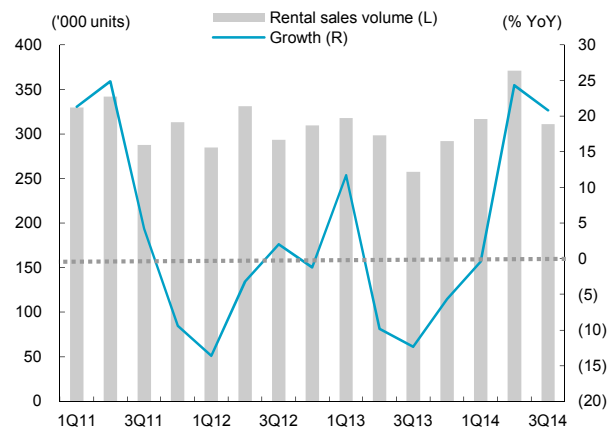
Note: Account standards changed from 2013. Excluding overdue and pending accounts
Source: Company data, Korea Investment securities & Investment

Figure 1. Visible recovery of 2014 new rental sales



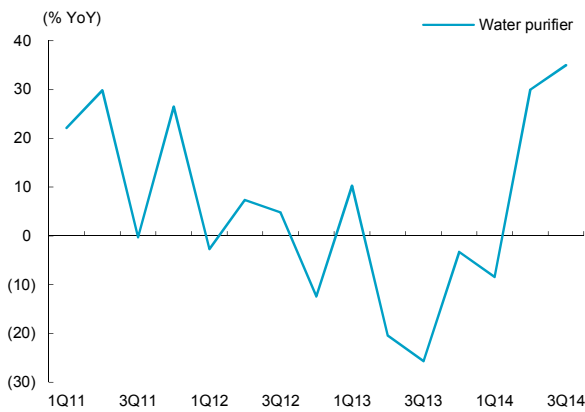
Source: Company data, Korea Investment securities & Investment

Figure 2. 3Q14 rental sales up 21% YoY



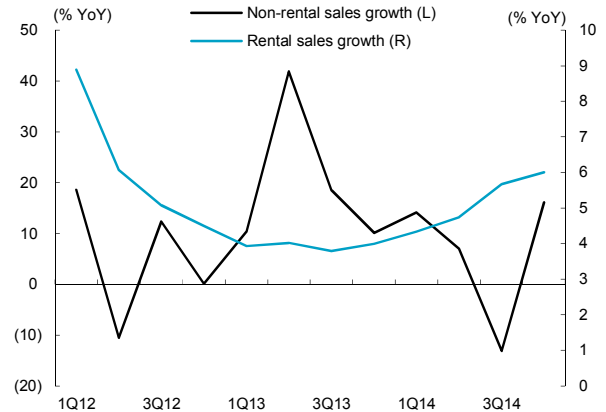
Source: Company data, Korea Investment securities & Investment

Figure 3. Water purifiers sales improvement continued



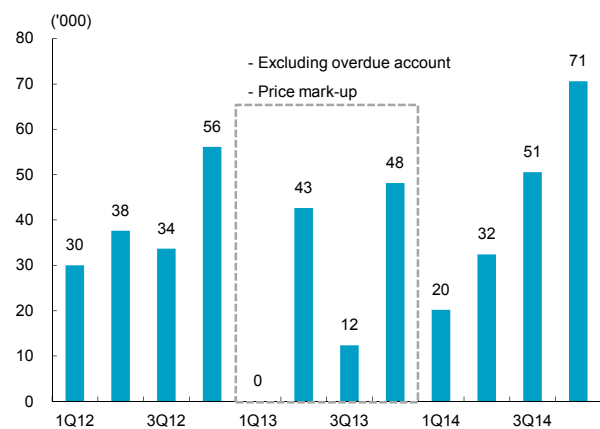
Source: Company data, Korea Investment securities & Investment

Figure 4. Rentals recover in 3Q14, rental & non-rental to improve in 4Q14



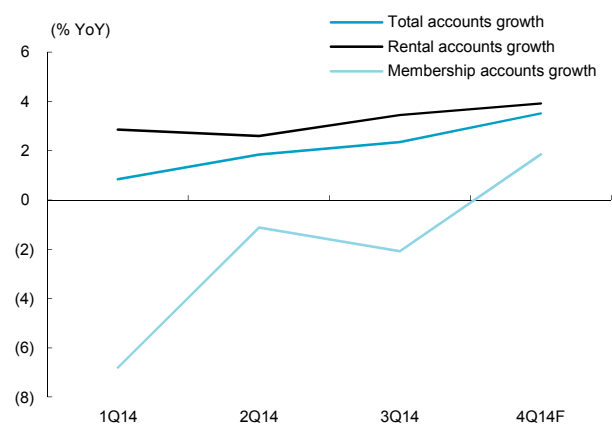
Source: Company data, Korea Investment securities & Investment

Figure 5. Rental accounts with high ARPU to net expand in 3Q14



Note: Account standards changed from 2013. Excluding overdue and pending accounts
Source: Company data, Korea Investment securities & Investment

Figure 6. Accounts to grow 2.3% at end-3Q14, 3.5% at end-4Q14



Source: Company data, 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 5.58mn accounts (rental users + memberships) as of end-1H 2014. 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 | 728 | 809 | 893 |
| Cash & cash equivalents | 152 | 239 | 251 | 291 | 330 |
| Accounts & other receivables | 262 | 250 | 263 | 286 | 311 |
| Inventory | 72 | 66 | 69 | 75 | 82 |
| Non-current assets | 976 | 976 | 1,013 | 1,063 | 1,116 |
| Investment assets | 54 | 55 | 58 | 63 | 68 |
| Tangible assets | 630 | 638 | 657 | 676 | 695 |
| Intangible assets | 184 | 177 | 186 | 202 | 220 |
| Total assets | 1,755 | 1,668 | 1,741 | 1,872 | 2,010 |
| Current liabilities | 759 | 677 | 626 | 606 | 576 |
| Accounts & other payables | 236 | 224 | 236 | 257 | 279 |
| ST debt & bonds | 330 | 182 | 132 | 82 | 32 |
| Current portion of LT debt | 110 | 146 | 146 | 146 | 146 |
| Non-current liabilities | 211 | 50 | 53 | 57 | 63 |
| Debentures | 118 | 0 | 0 | 0 | 0 |
| LT debt & financial liabilities | 36 | 0 | 0 | 0 | 0 |
| Total liabilities | 970 | 727 | 678 | 664 | 638 |
| Controlling interest | 785 | 941 | 1,062 | 1,209 | 1,371 |
| 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 | 989 | 1,136 | 1,299 |
| Minority interest | 0 | 0 | 0 | 0 | 0 |
| Shareholders' equity | 785 | 941 | 1,062 | 1,209 | 1,371 |

Cash flow

| FY-ending Dec. (W bn) | 2012A | 2013A | 2014F | 2015F | 2016F |
|--------------------------------|-------|-------|-------|-------|-------|
| C/F from operations | 454 | 537 | 438 | 509 | 541 |
| Net profit | 94 | 245 | 270 | 324 | 370 |
| Depreciation | 175 | 191 | 183 | 183 | 183 |
| Amortization | 8 | 8 | 8 | 9 | 9 |
| Net incr. in W/C | (24) | (41) | (23) | (8) | (23) |
| Others | 201 | 134 | 0 | 1 | 2 |
| C/F from investing | (319) | (76) | (227) | (241) | (245) |
| 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) | (17) | (25) | (27) |
| Others | 2 | 4 | (5) | (9) | (10) |
| C/F from financing | (76) | (373) | (198) | (228) | (258) |
| Incr. in equity | 12 | 5 | 0 | 0 | 0 |
| Incr. in debt | 20 | (262) | (50) | (50) | (50) |
| Dividends | (78) | (78) | (202) | (148) | (178) |
| Others | (30) | (38) | 54 | (30) | (30) |
| C/F from others | (5) | (1) | 0 | 0 | 0 |
| Increase in cash | 54 | 86 | 12 | 40 | 39 |

Note: K-IFRS (consolidated)

Income statement

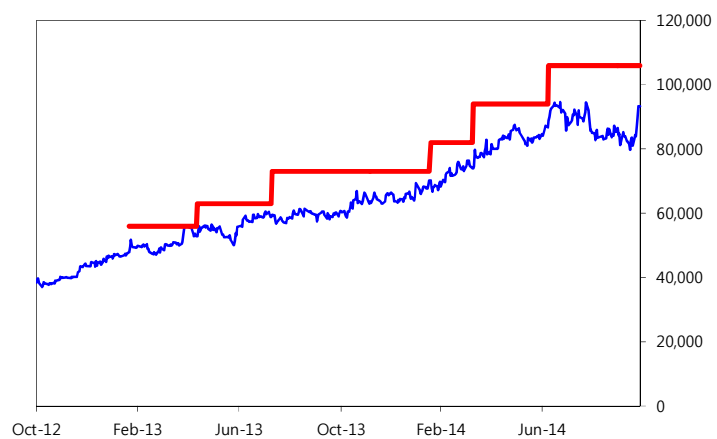
| FY-ending Dec. (W bn) | 2012A | 2013A | 2014F | 2015F | 2016F |
|--|-------|-------|-------|-------|-------|
| Sales | 1,993 | 2,118 | 2,229 | 2,424 | 2,638 |
| COGS | 678 | 721 | 774 | 822 | 884 |
| Gross profit | 1,315 | 1,397 | 1,456 | 1,602 | 1,754 |
| SG&A expenses | 1,088 | 1,058 | 1,073 | 1,173 | 1,267 |
| Operating profit | 226 | 339 | 382 | 430 | 487 |
| Financial income | 2 | 4 | (1) | 7 | 8 |
| Interest income | 2 | 4 | 6 | 7 | 8 |
| Financial expenses | 30 | 19 | 9 | 8 | 6 |
| Interest expenses | 30 | 19 | 9 | 8 | 6 |
| Other non-operating profit | (58) | (15) | (17) | (1) | 0 |
| Gains (Losses) in associates, subsidiaries and JV | 5 | 18 | 0 | 0 | 0 |
| Earnings before tax | 146 | 327 | 356 | 428 | 488 |
| Income taxes | 52 | 82 | 86 | 104 | 118 |
| Net profit | 94 | 245 | 270 | 324 | 370 |
| Net profit of controlling interest | 94 | 245 | 270 | 324 | 370 |
| Other comprehensive profit | 5 | (1) | 0 | 0 | 0 |
| Total comprehensive profit | 99 | 244 | 270 | 324 | 370 |
| Total comprehensive profit of controlling interest | 99 | 244 | 270 | 324 | 370 |
| EBITDA | 410 | 537 | 574 | 622 | 679 |

Key financial data

| FY-ending Dec. | 2012A | 2013A | 2014F | 2015F | 2016F |
|-----------------------|--------|--------|--------|--------|--------|
| Per-share data (KRW) | | | | | |
| EPS | 1,267 | 3,283 | 3,629 | 4,375 | 4,994 |
| BPS | 11,354 | 13,535 | 15,109 | 17,008 | 19,118 |
| DPS | 0 | 2,710 | 2,000 | 2,400 | 2,800 |
| Growth (%) | | | | | |
| Sales growth | 9.2 | 6.3 | 5.2 | 8.8 | 8.8 |
| OP growth | (3.7) | 49.9 | 12.8 | 12.4 | 13.2 |
| NP growth | (43.7) | 160.6 | 10.0 | 20.3 | 14.1 |
| EPS growth | (43.3) | 159.1 | 10.5 | 20.6 | 14.1 |
| EBITDA growth | 3.9 | 31.1 | 6.8 | 8.4 | 9.3 |
| Profitability (%) | | | | | |
| OP margin | 11.3 | 16.0 | 17.2 | 17.7 | 18.5 |
| NP margin | 4.7 | 11.6 | 12.1 | 13.4 | 14.0 |
| EBITDA margin | 20.6 | 25.4 | 25.7 | 25.7 | 25.8 |
| ROA | 5.6 | 14.3 | 15.8 | 18.0 | 19.1 |
| ROE | 12.3 | 28.4 | 26.9 | 28.6 | 28.7 |
| Dividend yield | - | 4.1 | 2.1 | 2.6 | 3.0 |
| Dividend payout ratio | 0.0 | 82.4 | 55.0 | 54.9 | 56.1 |
| Stability | | | | | |
| Net debt (W bn) | 439 | 90 | 27 | (63) | (153) |
| Debt/equity ratio (%) | 75.7 | 35.6 | 26.8 | 19.4 | 13.5 |
| Valuation (x) | | | | | |
| PE | 34.4 | 20.2 | 25.7 | 21.3 | 18.7 |
| PB | 3.8 | 4.9 | 6.2 | 5.5 | 4.9 |
| EV/EBITDA | 9.0 | 9.5 | 12.4 | 11.3 | 10.2 |

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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- 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. does not own over 1% of Coway shares as of October 27, 2014.

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

Neither the analyst/analysts who prepared this report nor their associates own any shares of the company/companies covered in this report as of October 27, 2014.

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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