

Earnings preview

Korea / Consumer

11 December 2014

BUY

Target price **KRW105,000**

Last price (9 Dec 2014) **KRW85,800**

Upside/downside (%)	22.4
KOSPI	1,970.95
Mkt. cap (KRW bn/USD bn)	6,617/5.9
52-week range (KRW)	63,000 - 94,600
Avg. trading value daily (KRW bn)	14.97
Foreign ownership (%)	55.1

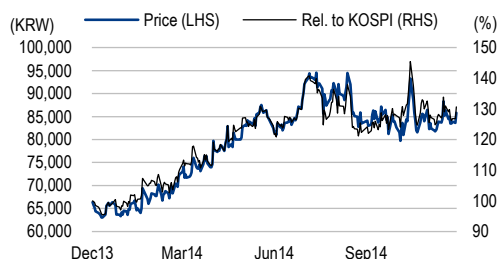
Source: Bloomberg

Forecast earnings & valuation

Fiscal year ending	Dec-13	Dec-14 E	Dec-15 E	Dec-16 E
Revenue (KRW bn)	2,118	2,176	2,330	2,460
EBIT (KRW bn)	339.0	382.6	466.3	525.2
Net profit (KRW bn)	245.1	280.6	349.8	396.2
Net profit (underlying)	245.1	280.5	349.7	396.2
EPS (KRW)	3,178	3,637	4,535	5,137
EPS growth (%)	160.6	14.5	24.7	13.3
P/E (x)	20.9	23.6	18.9	16.7
EV/EBITDA (x)	9.7	11.2	9.4	8.3
Dividend yield (%)	2.5	2.4	3.3	4.1
P/B (x)	5.4	6.0	5.1	4.5
ROE (%)	28.4	27.5	29.3	28.6
Net debt/equity (%)	8.8	(2.1)	(13.1)	(21.6)

Change to EPS	Dec-13	Dec-14 E	Dec-15 E	Dec-16 E
New (KRW)	3,178	3,637	4,535	5,137
Previous (KRW)	3,178	3,694	4,613	5,229
Chg. (%)	-	(1.5)	(1.7)	(1.8)

Performance



Performance	1M	3M	12M
Absolute (%)	2.1	2.8	32.2
Absolute (USD, %)	(0.5)	(6.5)	25.1
Relative to KOSPI (%)	0.5	6.6	33.7

Source: Bloomberg

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COWAY (021240 KS)

Earnings recovery back on track in 4Q

Our recent visit to Coway confirms the company's solid operations in its core rental business and overseas exports in 4Q14. We reiterate our BUY rating for Coway, as we expect its solid earnings growth and firm cash management, via higher cash returns to shareholders, to continue to draw investors' attention.

Earnings recovery in 4Q on solid rental business

We expect 4Q14 consolidated operating profit to reach KRW99.9bn (+9.6% YoY), which is roughly in line with consensus estimates. We attribute the strong growth in 4Q14 to: 1) continued strength in new rental contracts, with growth of over 20% YoY, helped by new rental products; 2) a recovery in ODM exports to China; and 3) controlled sales commission expenses. Moreover, the overall competitive landscape in the core rental business has remained soft in 4Q.

Figure 1 Coway's 4Q14 earnings preview

(KRWbn)	4Q14	4Q13	Chg. (YoY)	4Q14 (Cons.)	Diff. (%)
Sales	558.5	524.0	6.6	551.8	1.2
Operating profit	99.9	91.1	9.6	97.4	2.6
OPM (%)	17.9	17.4		17.7	
Net profit	84.2	67.9	24.1	76.8	9.7
NPM (%)	15.1	13.0		13.9	

Source: Company data, Bloomberg, Mirae Asset Research

Exports recover in 4Q

Coway exports air purifiers as an Original Design Manufacturer (ODM). 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 inventory adjustments were completed in 3Q14, its export sales have been recovering over 20% YoY in 4Q14.

Solid 2014-2015 earnings growth momentum

We project growth in Coway's EPS of 25% YoY in 2015. We think key earnings drivers will include: 1) monthly average revenue per user (ARPU) growth of 1-1.5% YoY, following rental-service fee hikes in April 2013 and new products; 2) healthy rental subscriber growth of 4% YoY for 2015, on the back of strong new rental contact growth in 2014 and lower subscription-cancellation ratios; and 3) management's continuing efforts on SG&A cost savings.

Clearer dividend policy

We expect strong earnings growth and stable capex to result in free cash flow (FCF) with a CAGR of 25% in 2015-16. With Coway's net cash position, we think the healthy free cash growth should lead to a decent increase in dividend payouts to maximize shareholder value. We believe ownership by MBK Partners is dividend-friendly, and expect Coway's dividend per share to rise to KRW3,500 by 2016.

Maintain BUY and target price of KRW105,000

The stock is currently trading at 18.9x 2015E PER, which is at par with its five-year historical average valuation. 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. We maintain BUY rating on Coway.

Figure 2 Quarterly earnings estimates

(KRW bn)	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14	3Q14	4Q14E	2014E	1Q15E	2Q15E	3Q15E	4Q15E	2015E
Sales	507.4	556.5	530.5	524.0	2,118.3	535.0	556.9	525.5	558.5	2,175.9	572.4	597.6	560.4	600.0	2,330.4
Operating profit	69.7	81.9	96.3	91.1	339.0	90.3	97.2	95.3	99.9	382.6	124.1	114.0	111.0	117.2	466.3
Recurring profit	75.3	81.0	80.4	90.4	327.1	88.4	86.5	85.9	113.2	374.1	124.1	114.0	111.0	117.2	466.3
Income tax	17.9	21.3	20.3	22.5	82.1	22.4	20.2	22.0	28.9	93.5	31.0	28.5	27.7	29.3	116.6
Tax rate (%)	23.8	26.3	25.3	24.9	25.1	25.3	23.4	25.6	25.6	25.0	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	63.9	84.2	280.6	93.1	85.5	83.2	87.9	349.8
Chg (% YoY)															
Sales	6.2	13.7	4.7	0.9	6.3	5.4	0.1	(0.9)	6.6	2.7	7.0	7.3	6.6	7.4	7.1
Operating profit	7.7	27.7	53.2	165.0	49.9	29.5	18.6	(1.0)	9.6	12.9	37.4	17.4	16.5	17.3	21.9
Recurring profit	21.4	1,724.1	44.5	282.5	124.4	17.4	6.8	6.9	25.1	14.3	40.3	31.8	29.1	3.6	24.7
Net profit	25.0	T/N	40.4	402.6	160.6	15.2	11.0	6.4	24.1	14.5	40.8	29.0	30.2	4.4	24.7
Margins (%)															
Operating margin	13.7	14.7	18.1	17.4	16.0	16.9	17.4	18.1	17.9	17.6	21.7	19.1	19.8	19.5	20.0
Recurring margin	14.8	14.6	15.2	17.3	15.4	16.5	15.5	16.4	20.3	17.2	21.7	19.1	19.8	19.5	20.0
Net margin	11.3	10.7	11.3	13.0	11.6	12.4	11.9	12.2	15.1	12.9	16.3	14.3	14.9	14.7	15.0

Source: Coway, Mirae Asset Research

Summary financial statements

Profit & loss

Year end Dec 31 (KRW bn)	2013	2014E	2015E	2016E
Revenue	2,118	2,176	2,330	2,460
Cost of goods sold	721	717	763	809
Gross profit	1,397	1,459	1,568	1,651
SG&A	1,058	1,076	1,101	1,126
EBIT (Adj.)	339	383	466	525
EBIT	339	383	466	525
Net interest income (loss)	(14)	(3)	(2)	1
Income (loss) from associates	0	0	0	0
Others	3	(6)	2	2
Recurring profit	327	374	466	528
Income tax	82	94	117	132
Net profit	245	281	350	396
Net profit (Controlling Interests)	245	281	350	396
EPS (Controlling Interests, KRW)	3,178	3,637	4,535	5,137

Growth & margins (%)	2013	2014E	2015E	2016E
Revenue growth	6.3	2.7	7.1	5.5
Gross profit growth	6.3	4.4	7.5	5.3
EBIT growth	49.9	12.9	21.9	12.6
Net profit growth	160.6	14.5	24.7	13.3
EPS growth	160.6	14.5	24.7	13.3
Gross margin	66.0	67.0	67.3	67.1
EBIT margin	16.0	17.6	20.0	21.4
Net profit margin	11.6	12.9	15.0	16.1

Source: COWAY, Mirae Asset Research estimates

Cash flow

Year end Dec 31 (KRW bn)	2013	2014E	2015E	2016E
Cash flow from operations	537	531	572	631
Net profit	245	281	350	396
Depr. & amortization	198	207	223	235
Others	135	52	48	47
Change in working capital	(41)	(9)	(48)	(48)
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)	(154)	(210)
Dividends	(78)	(124)	(154)	(210)
Increase in equity	0	0	0	0
Increase in debt	(262)	(208)	0	0
Beginning cash*	156	245	143	289
Ending cash*	245	143	289	439

Source: COWAY, Mirae Asset Research estimates

Note: *Including short-term financial asset

Balance sheet

Year end Dec 31 (KRW bn)	2013	2014E	2015E	2016E
Current assets	691	558	734	908
Cash & equivalents	239	109	117	123
Short-term financial asset	6	34	173	316
Accounts receivable	213	208	222	235
Inventory	66	57	61	64
Other current assets	168	151	161	170
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	1,627	1,850	2,059
Current liabilities	677	358	384	405
Accounts payable	37	38	40	43
Short-term debt	328	0	0	0
Other current liabilities	312	321	343	362
Non-current liabilities	50	171	173	175
Long-term debt	0	120	120	120
Other long-term liabilities	50	51	53	55
Total liabilities	727	529	557	580
Controlling Interests	941	1,098	1,293	1,480
Non-Controlling Interests	0	0	0	0
Shareholder's equity	941	1,098	1,293	1,480
BVPS(KRW)	12,200	14,234	16,769	19,185

Source: COWAY, Mirae Asset Research estimates

Ratio analysis

Year end Dec 31	2013	2014E	2015E	2016E
ROE (%)	28.4	27.5	29.3	28.6
ROA (%)	14.3	17.0	20.1	20.3
Inventory days	11.8	10.3	9.2	9.3
Receivables days	38.4	35.2	33.7	33.9
Payable days	7.1	6.2	6.1	6.2
Net debt/equity (%)	8.8	(2.1)	(13.1)	(21.6)
Interest cover (x)	23.4	133.5	264.6	(438.5)

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

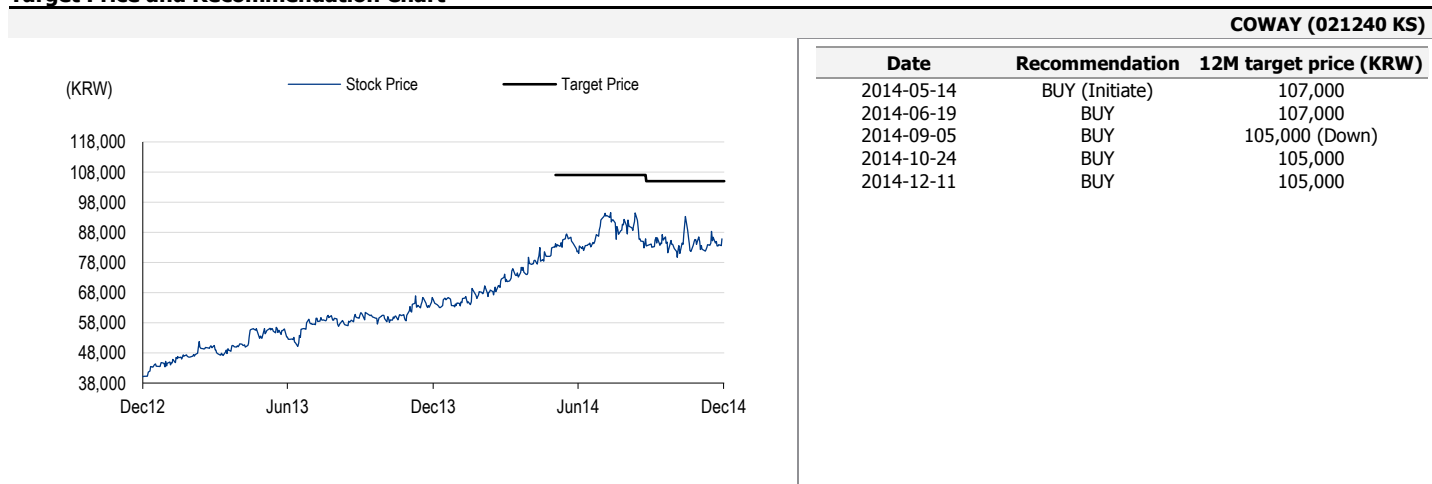
By industry

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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