

Coway

(021240 KS)

A safe bet during times of uncertainty

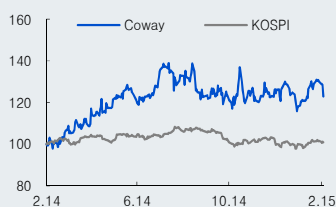
Consumer Services

Results Comment
February 13, 2015

| | |
|--------------------------|----------------|
| (Maintain) | Buy |
| Target Price (12M, W) | 130,000 |
| Share Price (2/12/15, W) | 83,700 |
| Expected Return | 55% |

| | |
|----------------------------|----------|
| OP (14P, Wbn) | 364 |
| Consensus OP (14F, Wbn) | 379 |
| EPS Growth (14P, %) | 2.0 |
| Market EPS Growth (14F, %) | -1.9 |
| P/E (14P, x) | 26.0 |
| Market P/E (14F, x) | 13.4 |
| KOSPI | 1,941.63 |
| Market Cap (Wbn) | 6,455 |
| Shares Outstanding (mn) | 77 |
| Free Float (%) | 65.2 |
| Foreign Ownership (%) | 54.0 |
| Beta (12M) | -0.10 |
| 52-Week Low | 66,700 |
| 52-Week High | 94,600 |

| (%) | 1M | 6M | 12M |
|----------|-----|------|------|
| Absolute | 3.7 | -4.3 | 23.6 |
| Relative | 2.6 | 0.6 | 23.3 |



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4Q14 review: Parent OP comes in line with our estimate at W93.2bn (+6.4% YoY)

For 4Q14, Coway reported non-consolidated revenue of W499.5bn (+3.6% YoY) and operating profit of W93.2bn (+6.4% YoY; OP margin of 18.7%), which was in line with our projection (W93.5bn; OP margin of 18.5%). Although a rise in new accounts put upside pressures on SG&A expenses, we believe the company was able to maintain solid margins thanks to its superior profit management ability.

Parent pretax profit, however, was weaker than expected due to impairment charges related to subsidiaries, which were reflected as non-operating expenses. In an effort to clean up its balance sheet, Coway recognized all of its impairment losses related to loss-making subsidiaries (Thailand, China, and GreenEntech) in 4Q14. Adjusting for the one-off charges, we estimate actual pretax profit was a stronger-than-projected W97.3bn.

The company's key quality indicators, rental asset disposal ratio and churn rate, remained stable, falling to record-lows of 2.7% and 0.95%, respectively.

Guidance strengthens confidence in growth

For 2015, management guided revenue growth of 8.3% YoY, operating profit growth of 11.3% YoY, and OP margin of 19.3%. For the rental business, revenue is spread out over time, but commission expenses related to new accounts are recorded all at once. Considering this short-term pressure on expenses, we consider management's growth and profit targets very encouraging.

We are highly confident in management's guidance. In 2014, new rental accounts beat guidance (1.25mn units) by 14.1%, rising to 1.33mn units. New rental accounts from 2014 should directly lead to higher ARPU, as price hikes were applied last year to new accounts. The company set its 2015 new rental account target at a record-high of 1.42mn units, confirming its confidence in its traditional CODY customer service network as well as its new offline channel.

Retain Buy and Raise TP to W130,000; Strong growth conviction

We believe Coway's 2014 business performance and 2015 guidance validates the unique strength of the rental business, the company's product development, and the strength of its CODY network and service quality.

We reiterate Buy on Coway and lift our target price by 8.3% to W130,000 to reflect our upward earnings revisions. We believe Coway is a safe bet at a time when the consumer environment looks increasingly uncertain. We recommend the stock as one of our top picks in consumer discretionary.

| FY (Dec.) | 12/11 | 12/12 | 12/13 | 12/14P | 12/15F | 12/16F |
|---------------|-------|-------|-------|--------|--------|--------|
| Revenue (Wbn) | 1,824 | 1,993 | 2,118 | 2,160 | 2,347 | 2,514 |
| OP (Wbn) | 235 | 226 | 339 | 364 | 432 | 485 |
| OP margin (%) | 12.9 | 11.3 | 16.0 | 16.9 | 18.4 | 19.3 |
| NP (Wbn) | 167 | 94 | 245 | 250 | 310 | 354 |
| EPS (W) | 2,166 | 1,219 | 3,178 | 3,241 | 4,014 | 4,588 |
| ROE (%) | 22.2 | 12.3 | 28.4 | 25.2 | 27.6 | 27.6 |
| P/E (x) | 16.9 | 35.7 | 20.9 | 26.0 | 20.9 | 18.2 |
| P/B (x) | 3.3 | 3.8 | 4.9 | 5.5 | 4.8 | 4.3 |

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. 4Q14P review (non-consolidated)

(Wbn, %)

| | 4Q13 | 3Q14 | 4Q14P | | | Growth | |
|------------------|------|------|-------------|------------|-----------|--------|-------|
| | | | Preliminary | KDB Daewoo | Consensus | YoY | QoQ |
| Revenue | 482 | 496 | 500 | 506 | 518 | 3.6 | 0.7 |
| Operating profit | 88 | 97 | 93 | 94 | 100 | 6.4 | -3.9 |
| OP margin | 18.2 | 19.5 | 18.7 | 18.5 | 19.4 | | |
| Pretax profit | 72 | 88 | 67 | 87 | 101 | -6.7 | -24.1 |
| Net profit | 50 | 66 | 45 | 65 | 75 | -9.7 | -31.7 |

Note: One-off impairment losses of W30.6bn related to subsidiaries were reflected as non-operating expenses

Source: Company data, KDB Daewoo Securities Research

Table 2. 4Q14P review (consolidated)

(Wbn, %)

| | 4Q13 | 3Q14 | 4Q14P | | | Growth | |
|------------------|------|------|-------------|------------|-----------|--------|-------|
| | | | Preliminary | KDB Daewoo | Consensus | YoY | QoQ |
| Revenue | 524 | 526 | 543 | 533 | 548 | 3.6 | 3.3 |
| Operating profit | 91 | 95 | 82 | 89 | 96 | -10.3 | -14.3 |
| OP margin | 17.4 | 18.1 | 15.0 | 16.8 | 17.6 | | |
| Pretax profit | 90 | 86 | 72 | 86 | 96 | -20.9 | -16.8 |
| Net profit | 68 | 64 | 53 | 65 | 71 | -21.3 | -16.5 |

Notes: One-off impairment losses of W15.7bn related to subsidiaries were reflected in consolidated operating profit; excluding the expense, actual operating profit would be W97.4bn

Source: Company data, KDB Daewoo Securities Research

Table 3. Quarterly earnings

(Wbn, %)

| | 1Q13 | 2Q13 | 3Q13 | 4Q13 | 1Q14 | 2Q14 | 3Q14 | 4Q14P |
|--|------|------|------|------|------|------|------|-------|
| Revenue | 507 | 556 | 531 | 524 | 535 | 557 | 526 | 543 |
| Operating profit | 70 | 82 | 96 | 91 | 90 | 97 | 95 | 82 |
| OP margin | 13.7 | 14.7 | 18.1 | 17.4 | 16.9 | 17.4 | 18.1 | 15.1 |
| Net profit | 57 | 60 | 60 | 68 | 66 | 66 | 64 | 54 |
| Net margin | 11 | 11 | 11 | 13 | 12 | 12 | 12 | 10 |
| Rental asset disposal losses | 12 | 10 | 9 | 8 | 10 | 11 | 10 | 10 |
| (% of rental revenue; non-consolidated) | 4 | 3 | 3 | 2 | 3 | 3 | 3 | 3 |

Source: Company data, KDB Daewoo Securities Research

Table 4. Earnings forecast revisions

(Wbn, %)

| | Previous | | Revised | | % chg. | | Notes |
|------------------|----------|-------|---------|-------|--------|-----|--|
| | 14P | 15F | 14P | 15F | 14P | 15F | |
| Revenue | 2,157 | 2,326 | 2,160 | 2,347 | 0.1 | 0.9 | |
| Operating profit | 372 | 424 | 364 | 432 | -2.1 | 1.9 | - Reflects FY14 impairment losses |
| Pretax profit | 347 | 402 | 333 | 413 | -4.2 | 2.6 | - Reflects FY15 cost efficiency improvements |
| Net profit | 261 | 302 | 250 | 310 | -4.4 | 2.4 | |

Source: KDB Daewoo Securities Research

Table 5. DCF valuation

(Wbn, %)

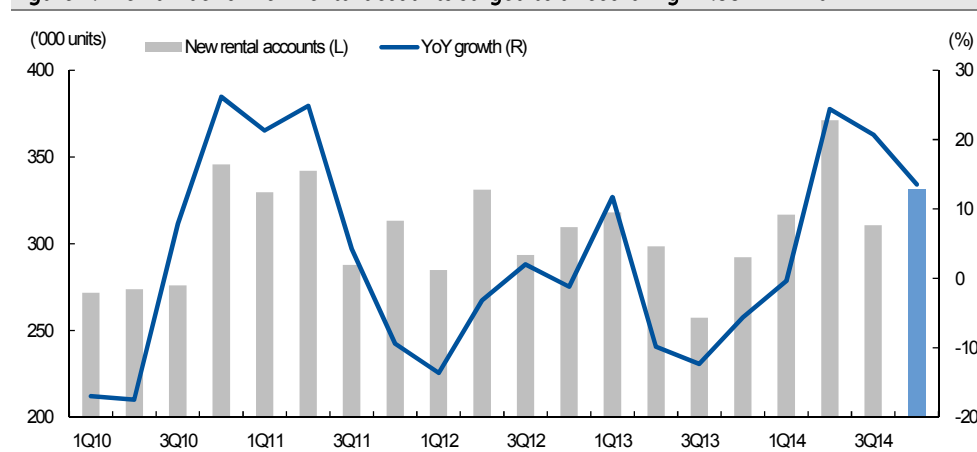
| | 15F | 16F | 17F | 18F |
|--------------------------------|------------|------------|------------|------------|
| EBIT | 432 | 485 | 495 | 506 |
| - Taxes | 108 | 121 | 124 | 126 |
| - Capex | 290 | 301 | 308 | 314 |
| - Change in working capital | 44 | 37 | 38 | 39 |
| + Depreciation | 183 | 196 | 200 | 204 |
| + Amortization | 8 | 8 | 8 | 8 |
| + Rental asset disposal losses | 40 | 43 | 44 | 44 |
| FCFF | 221 | 272 | 277 | 283 |

| | |
|-----------------|--------|
| Final-year FCFF | 265 |
| Terminal value | 11,153 |
| Terminal growth | 2% |

| | |
|-----------------------------|----------------|
| NPV of FCFF | 1,133 |
| PV of terminal value | 8,926 |
| Enterprise value | 10,060 |
| Cash & equivalents | 182 |
| Other investments | 6 |
| Interest-bearing debt | 257 |
| Minority interests | 0 |
| Preferred shares | 0 |
| Current equity value | 9,991 |
| Shares outstanding | 77,125 |
| Target price (W) | 130,000 |
| Current price (W) | 83,700 |
| Upside | 55.3% |

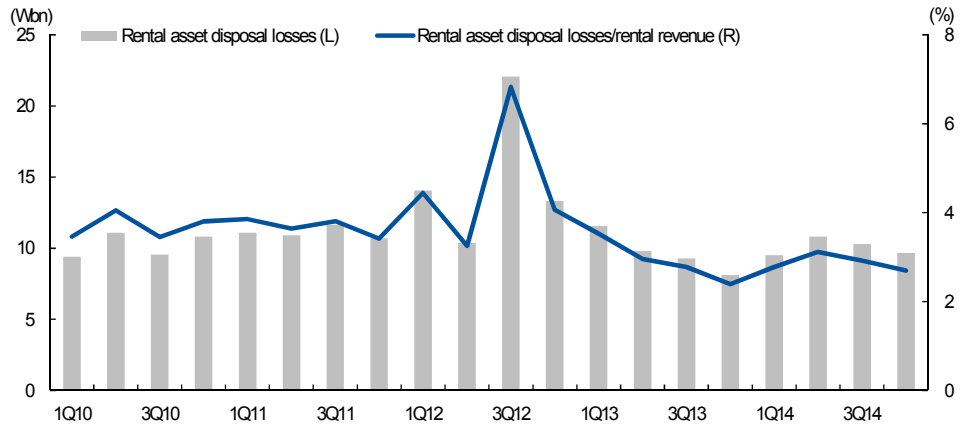
Source: KDB Daewoo Securities Research

Figure 1. The number of new rental accounts surged to a record-high 1.33mn in 2014



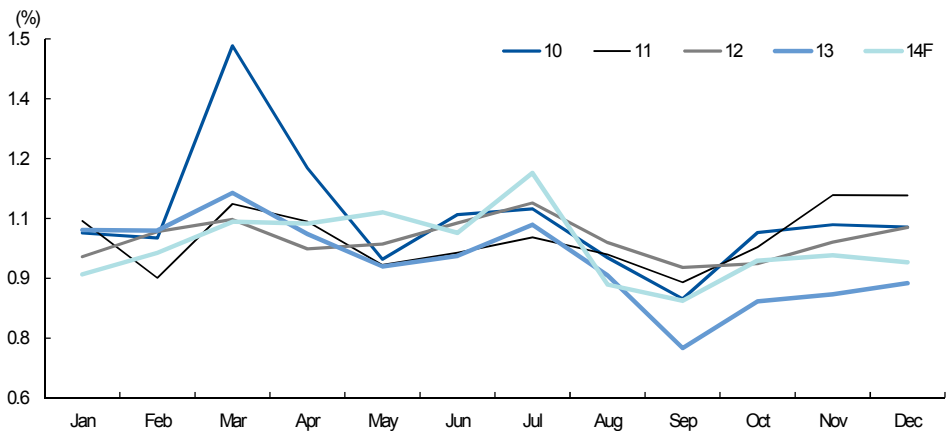
Source: Company data, KDB Daewoo Securities Research

Figure 2. Rental asset disposal ratio fell to a record-low 2.7%



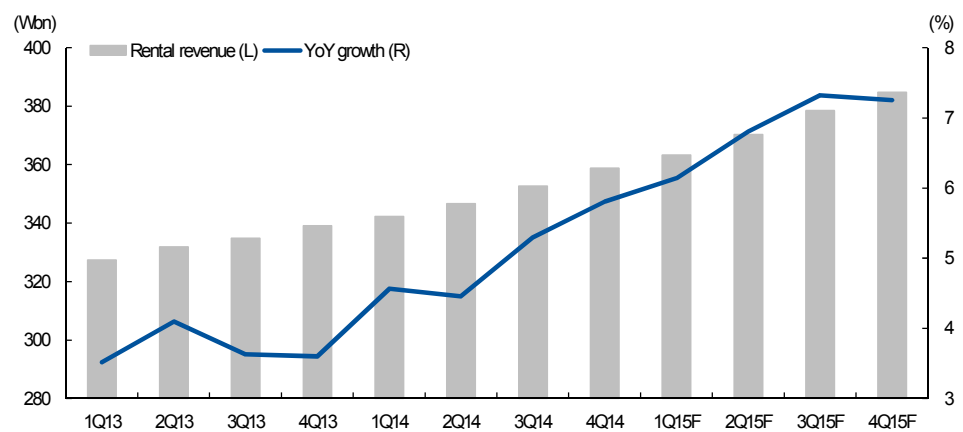
Source: Company data, KDB Daewoo Securities Research

Figure 3. Rental churn rate trends



Source: Company data, KDB Daewoo Securities Research

Figure 4. Rental revenue growth rate continuing to accelerate QoQ



Source: Company data, KDB Daewoo Securities Research

Coway (021240 KS/Buy/TP: W130,000)

Comprehensive Income Statement (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Revenue | 2,118 | 2,160 | 2,347 | 2,514 |
| Cost of Sales | 721 | 727 | 777 | 834 |
| Gross Profit | 1,397 | 1,433 | 1,570 | 1,680 |
| SG&A Expenses | 1,058 | 1,069 | 1,138 | 1,195 |
| Operating Profit (Adj) | 339 | 364 | 432 | 485 |
| Operating Profit | 339 | 364 | 432 | 485 |
| Non-Operating Profit | -12 | -31 | -19 | -13 |
| Net Financial Income | -14 | -9 | -7 | -5 |
| Net Gain from Inv in Associates | 18 | 0 | 0 | 0 |
| Pretax Profit | 327 | 333 | 413 | 472 |
| Income Tax | 82 | 83 | 103 | 118 |
| Profit from Continuing Operations | 245 | 250 | 310 | 354 |
| Profit from Discontinued Operations | 0 | 0 | 0 | 0 |
| Net Profit | 245 | 250 | 310 | 354 |
| Controlling Interests | 245 | 250 | 310 | 354 |
| Non-Controlling Interests | 0 | 0 | 0 | 0 |
| Total Comprehensive Profit | 244 | 246 | 310 | 354 |
| Controlling Interests | 244 | 246 | 310 | 354 |
| Non-Controlling Interests | 0 | 0 | 0 | 0 |
| EBITDA | 537 | 569 | 621 | 687 |
| FCF (Free Cash Flow) | 269 | 177 | 162 | 214 |
| EBITDA Margin (%) | 25.4 | 26.3 | 26.5 | 27.3 |
| Operating Profit Margin (%) | 16.0 | 16.9 | 18.4 | 19.3 |
| Net Profit Margin (%) | 11.6 | 11.6 | 13.2 | 14.1 |

Statement of Financial Condition (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|----------------------------------|--------------|--------------|--------------|--------------|
| Current Assets | 691 | 654 | 689 | 786 |
| Cash and Cash Equivalents | 239 | 182 | 180 | 243 |
| AR & Other Receivables | 227 | 227 | 249 | 267 |
| Inventories | 66 | 77 | 85 | 91 |
| Other Current Assets | 159 | 168 | 175 | 185 |
| Non-Current Assets | 976 | 1,021 | 1,086 | 1,146 |
| Investments in Associates | 0 | 0 | 0 | 0 |
| Property, Plant and Equipment | 638 | 672 | 739 | 801 |
| Intangible Assets | 177 | 173 | 166 | 159 |
| Total Assets | 1,668 | 1,674 | 1,775 | 1,932 |
| Current Liabilities | 677 | 557 | 490 | 476 |
| AP & Other Payables | 191 | 183 | 201 | 216 |
| Short-Term Financial Liabilities | 335 | 249 | 189 | 179 |
| Other Current Liabilities | 151 | 125 | 100 | 81 |
| Non-Current Liabilities | 50 | 76 | 83 | 91 |
| Long-Term Financial Liabilities | 0 | 8 | 8 | 8 |
| Other Non-Current Liabilities | 50 | 68 | 75 | 83 |
| Total Liabilities | 727 | 633 | 573 | 566 |
| Controlling Interests | 941 | 1,040 | 1,201 | 1,364 |
| Capital Stock | 41 | 41 | 41 | 41 |
| Capital Surplus | 126 | 126 | 126 | 126 |
| Retained Earnings | 868 | 991 | 1,152 | 1,315 |
| Non-Controlling Interests | 0 | 1 | 1 | 1 |
| Stockholders' Equity | 941 | 1,041 | 1,202 | 1,365 |

Cash Flows (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|--------------------------------|------------|-------------|-------------|-------------|
| Cash Flows from Op Activities | 537 | 468 | 452 | 515 |
| Net Profit | 245 | 250 | 310 | 354 |
| Non-Cash Income and Expense | 374 | 360 | 283 | 309 |
| Depreciation | 191 | 196 | 183 | 196 |
| Amortization | 8 | 8 | 7 | 7 |
| Others | 175 | 156 | 93 | 106 |
| Chg in Working Capital | -41 | -25 | -37 | -30 |
| Chg in AR & Other Receivables | 67 | -8 | -20 | -17 |
| Chg in Inventories | 19 | -10 | -7 | -6 |
| Chg in AP & Other Payables | -82 | -1 | 3 | 3 |
| Income Tax Paid | -41 | -117 | -103 | -118 |
| Cash Flows from Inv Activities | -76 | -275 | -237 | -243 |
| Chg in PP&E | -258 | -275 | -250 | -258 |
| Chg in Intangible Assets | -2 | 0 | 0 | 0 |
| Chg in Financial Assets | -4 | -2 | -6 | -5 |
| Others | 188 | 2 | 19 | 20 |
| Cash Flows from Fin Activities | -373 | -251 | -217 | -208 |
| Chg in Financial Liabilities | -260 | -78 | -60 | -10 |
| Chg in Equity | 0 | 0 | 0 | 0 |
| Dividends Paid | -78 | -124 | -148 | -191 |
| Others | -35 | -49 | -9 | -7 |
| Increase (Decrease) in Cash | 86 | -57 | -2 | 64 |
| Beginning Balance | 152 | 239 | 182 | 180 |
| Ending Balance | 239 | 182 | 180 | 243 |

Source: Company data, KDB Daewoo Securities Research estimates

Forecasts/Valuations (Summarized)

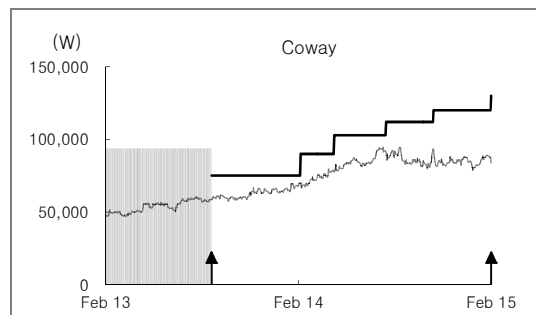
| | 12/13 | 12/14F | 12/15F | 12/16F |
|----------------------------------|--------|--------|--------|--------|
| P/E (x) | 20.9 | 26.0 | 20.9 | 18.2 |
| P/CF (x) | 8.3 | 10.7 | 10.9 | 9.7 |
| P/B (x) | 4.9 | 5.5 | 4.8 | 4.3 |
| EV/EBITDA (x) | 9.7 | 11.5 | 10.4 | 9.3 |
| EPS (W) | 3,178 | 3,241 | 4,014 | 4,588 |
| CFPS (W) | 8,030 | 7,906 | 7,677 | 8,589 |
| BPS (W) | 13,535 | 15,190 | 17,280 | 19,395 |
| DPS (W) | 2,710 | 2,000 | 2,571 | 2,939 |
| Payout ratio (%) | 82.4 | 59.4 | 61.6 | 61.6 |
| Dividend Yield (%) | 4.1 | 2.4 | 3.1 | 3.5 |
| Revenue Growth (%) | 6.3 | 2.0 | 8.7 | 7.1 |
| EBITDA Growth (%) | 31.0 | 6.0 | 9.1 | 10.6 |
| Operating Profit Growth (%) | 50.0 | 7.4 | 18.7 | 12.3 |
| EPS Growth (%) | 160.7 | 2.0 | 23.9 | 14.3 |
| Accounts Receivable Turnover (x) | 9.5 | 10.2 | 10.6 | 10.5 |
| Inventory Turnover (x) | 30.8 | 30.2 | 28.9 | 28.6 |
| Accounts Payable Turnover (x) | 17.4 | 20.2 | 21.0 | 20.8 |
| ROA (%) | 14.3 | 15.0 | 17.9 | 19.1 |
| ROE (%) | 28.4 | 25.2 | 27.6 | 27.6 |
| ROIC (%) | 23.0 | 26.1 | 28.1 | 29.1 |
| Liability to Equity Ratio (%) | 77.3 | 60.8 | 47.7 | 41.5 |
| Current Ratio (%) | 102.2 | 117.4 | 140.6 | 165.1 |
| Net Debt to Equity Ratio (%) | 9.5 | 6.6 | 0.8 | -4.7 |
| Interest Coverage Ratio (x) | 18.2 | 30.4 | 48.4 | 63.8 |

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

| Company (Code) | Date | Rating | Target Price |
|----------------|------------|-------------|--------------|
| Coway (021240) | 02/12/2015 | Buy | 130,000 |
| | 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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