

Coway (021240.KS)

Company Comment | May 7, 2015

Growth at core business robust

While Coway's 1Q15 earnings missed consensus—due to a sales contraction at its ODM business (China)—we are now able to confirm that sales momentum at the firm's domestic business remains intact (sales up 7% y-y). Despite the lack of overseas sales growth, we believe that the company is well positioned to maintain a high dividend payout ratio. As such, we stick to our Buy rating.

1Q15 results: Overseas business sluggish, while domestic business upbeat

- On an IFRS non-consolidated basis, Coway announced 1Q15 sales of W506.1bn (up 2.3% y-y) and operating profit of W98.9bn (up 10.2% y-y), with both of the numbers missing consensus and our estimates.
- In detail, we attribute the disappointing sales growth to sluggish sales at its overseas business. Due to intensifying competition in the air purifier segment (in China), the play's ODM air purifier sales shrank 27.5% y-y. We point out that the overseas business generates roughly 7% of Coway's sales and around 5% of its operating profit (its margins are lower than that at Coway's other businesses).
- However, sales at the health appliance division—the firm's core business—rose 6.1% y-y thanks to: 1) favorable rental sales growth (up 7.5% y-y) and lump-sum sales improvement (up 7.4% y-y). In addition, both the rental cancellation ratio and loss rate on rental asset disposals (both are key profit determinants for the company) continue to be well managed. Given these positives and despite the soft numbers at the overseas business, Coway continues to successfully defended its operating profit.

Maintain Buy and raise target price to W110,000

- We maintain Buy and raise our target price from W100,000 to W110,000 in line with moving the valuation period used in our discount cash flow (DCF) model. However, we lower our 2015, 2016, and 2017 earnings estimates due to sluggish exports.
- We expect the firm's dividend payout ratio (currently around 50%) to be raised to 60% in 2015 and to 70% in 2016.
- Given its: 1) dividend merit (2.8%); 2) stable business (centers on renting out products); and 3) unique earnings structure (relatively free from the economic cycle), we positively view Coway.

1Q15 review

(Unit: Wbn, %)

| | 1Q14 | 2Q14 | 3Q14 | 4Q14 | 1Q15P | | | | | 2Q15E |
|------------------|------|------|------|------|--------|------|------|-----------|-----------|-------|
| | | | | | Actual | y-y | q-q | Estimates | Consensus | |
| Sales | 495 | 523 | 496 | 500 | 506 | 2.3 | 1.3 | 536 | 530 | 531 |
| Operating profit | 90 | 98 | 97 | 93 | 99 | 10.2 | 2.5 | 103 | 100 | 109 |
| Operating margin | 18.1 | 18.7 | 19.5 | 18.7 | 19.5 | | | 19.2 | 18.9 | 20.5 |
| Pretax profit | 88 | 87 | 88 | 67 | 98 | 11.5 | 46.3 | 101 | 105 | 108 |
| Net profit | 66 | 65 | 66 | 45 | 73 | 9.9 | 60.4 | 72 | 78 | 78 |

Note: IFRS non-consolidated basis

Source: Coway, FnGuide, NH I&S research center estimates

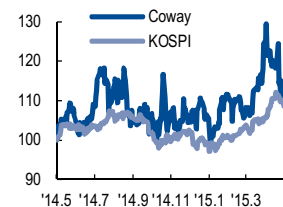
Buy (maintain)

TP **W110,000 (raise)**
CP ('15/05/06) **W92,000**

Sector **Other commodities**

| | |
|-----------------------------|---------------|
| Kospi | 2,104.58 |
| Kosdaq | 665.94 |
| Market cap (common) | US\$6,561.4mn |
| Outstanding shares (common) | 77.1mn |
| 52W high ('15/04/07) | W103,500 |
| low ('15/01/08) | W78,900 |
| Average trading value (60D) | US\$16.9mn |
| Dividend yield (2014) | 2.4% |
| Foreign ownership | 54.6% |

Price trend



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DCF-based target price of W110,000

| | 2014 | 2015E | 2016F | 2017F | 2018F | 2019F | 2020F |
|------------------------|----------------|-------|-------|-------|-------|-------|-------|
| EBIT | 377 | 426 | 432 | 453 | 487 | 518 | 418 |
| NOPLAT | 281 | 314 | 318 | 334 | 359 | 382 | 308 |
| DEP+AMOR | 200 | 163 | 171 | 171 | 178 | 189 | 198 |
| CAPEX | 276 | 178 | 196 | 172 | 202 | 227 | 231 |
| FCF | 233 | 298 | 291 | 354 | 353 | 354 | 284 |
| Discount factor | | 0.95 | 0.90 | 0.86 | 0.82 | 0.78 | 0.74 |
| PV of FCF | | 283 | 263 | 304 | 288 | 275 | 209 |
| Sum of PV | 1,622 | | | | | | |
| Continuing Value | | | | | | | |
| Noplat as of 2019 | 308 | | | | | | |
| g | 2.0 | | | | | | |
| ROIC | 30.4 | | | | | | |
| CV at the end of 2019 | 9,007 | | | | | | |
| discount factor | 0.74 | | | | | | |
| PV of Continuing Value | 6,641 | | | | | | |
| Equity Value | 8,319 | | | | | | |
| +net debt | 57 | | | | | | |
| -minority interest | 0 | | | | | | |
| -Preferred Stock | 0 | | | | | | |
| mid-year adjust factor | 1.02 | | | | | | |
| Current Equity Value | 8,469 | | | | | | |
| Per share Value | 109,809 | | | | | | |
| shares outstanding | 77,125 | | | | | | |
| Present price | 92,000 | | | | | | |
| Upside (%) | 19.4 | | | | | | |

[Key assumptions]

g=2.0%

Rf=2.0%

Rp=6.0%

Beta=0.7

Source: NH I&S Research Center estimates

Earnings forecasts (IFRS non-consolidated)

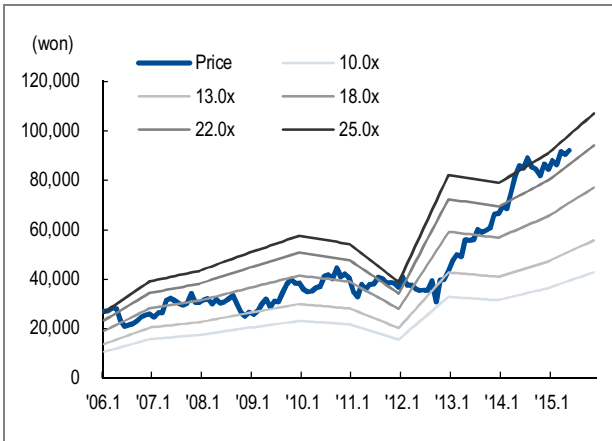
(Units: Wbn, won, x, %)

| | | 2014 | 2015E | 2016F | 2017F |
|--------------------------------------|------------|---------|---------|---------|---------|
| Sales | - Revised | 2,013.6 | 2,065.4 | 2,090.1 | 2,172.5 |
| | - Previous | | 2,190.3 | 2,280.1 | 2,418.3 |
| | - Change | | -5.7 | -8.3 | -10.2 |
| Operating profit | - Revised | 377.5 | 425.6 | 432.0 | 453.2 |
| | - Previous | | 424.8 | 458.8 | 498.5 |
| | - Change | | 0.2 | -5.8 | -9.1 |
| Operating margin (revised) | | 18.7 | 20.6 | 20.7 | 20.9 |
| EBITDA | | 577.0 | 588.6 | 602.5 | 624.6 |
| Net profit (excl minority interests) | | 242.9 | 331.8 | 334.9 | 349.1 |
| EPS | - Revised | 3,150 | 4,303 | 4,342 | 4,526 |
| | - Previous | | 4,230 | 4,539 | 4,893 |
| | - Change | | 1.7 | -4.4 | -7.5 |
| P/E | | 26.7 | 21.4 | 21.2 | 20.3 |
| P/B | | 6.1 | 5.7 | 5.1 | 4.7 |
| EV/EBITDA | | 11.4 | 11.9 | 11.4 | 10.9 |
| ROE | | 24.0 | 28.8 | 25.5 | 24.3 |

Note: Operating profit = sales – (COGS + SG&A expenses)

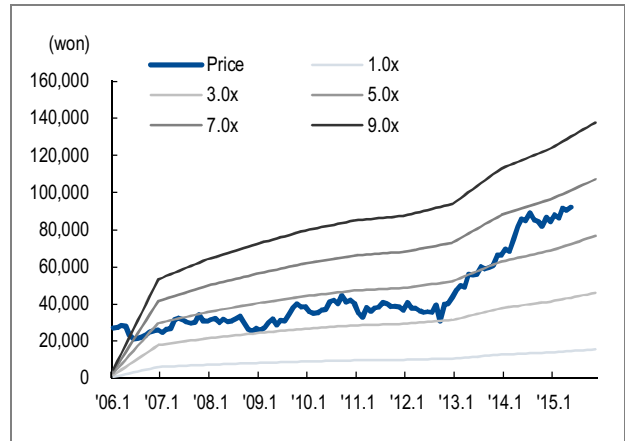
Source: NH I&S Research Center estimates

Forward P/E band



Source: DataGuide Pro

Trailing P/B band



Source: DataGuide Pro

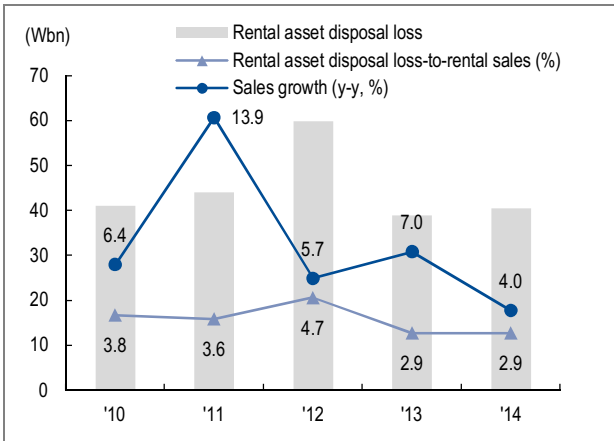
Earnings forecasts

(Units: Wbn, %)

| | 1Q13 | 2Q13 | 3Q13 | 4Q13 | 1Q14 | 2Q14 | 3Q14 | 4Q14 | 1Q15P | 2014 | 2015E |
|-------------------------|------------|-------------|------------|------------|------------|------------|------------|------------|------------|--------------|--------------|
| Sales | 465 | 497 | 489 | 482 | 495 | 523 | 496 | 500 | 506 | 2,014 | 2,065 |
| Rentals | 327 | 332 | 335 | 339 | 342 | 347 | 353 | 359 | 363 | 1,401 | 1,468 |
| Memberships | 43 | 43 | 43 | 44 | 44 | 46 | 47 | 47 | 46 | 183 | 195 |
| Lump-sum sales | 37 | 48 | 35 | 29 | 26 | 37 | 32 | 27 | 26 | 122 | 124 |
| Exports | 31 | 45 | 38 | 31 | 45 | 56 | 33 | 33 | 33 | 167 | 141 |
| Cosmetics | 18 | 22 | 17 | 20 | 21 | 22 | 17 | 20 | 23 | 80 | 84 |
| Others | 9 | 8 | 21 | 20 | 15 | 15 | 15 | 14 | 11 | 58 | 50 |
| Sales growth | 5.2 | 11.3 | 6.8 | 4.9 | 6.4 | 5.3 | 1.4 | 3.6 | 2.3 | 4.1 | 2.6 |
| Rentals | 3.5 | 4.1 | 3.6 | 3.6 | 4.6 | 4.5 | 5.3 | 5.8 | 7.5 | 5.0 | 4.8 |
| Memberships | 10.4 | 9.1 | 5.1 | 3.2 | 2.6 | 7.0 | 8.6 | 7.4 | 4.9 | 6.4 | 6.2 |
| Lump-sum sales | 11.9 | 18.1 | -9.3 | -9.3 | -29.6 | -21.8 | -10.4 | -9.1 | 7.4 | -18.5 | 1.5 |
| Exports | 5.0 | 111.4 | 35.6 | 0.2 | 43.6 | 25.1 | -13.0 | 9.3 | -27.5 | 15.8 | -15.6 |
| Cosmetics | 6.3 | 35.5 | -4.2 | 18.1 | 17.4 | 0.5 | 3.6 | 1.1 | 10.5 | 5.3 | 4.7 |
| Others | 16.1 | -25.8 | 125.6 | 85.0 | 63.4 | 98.4 | -31.0 | -31.1 | -28.2 | 1.1 | -15.1 |
| Gross profit | 311 | 329 | 319 | 323 | 326 | 343 | 334 | 338 | 347 | 1,340 | 1,392 |
| Gross margin | 66.8 | 66.2 | 65.3 | 67.0 | 65.8 | 65.5 | 67.2 | 67.7 | 68.5 | 66.6 | 67.4 |
| Operating profit | 69 | 79 | 97 | 88 | 90 | 98 | 97 | 93 | 99 | 377 | 426 |
| Growth | 7.9 | 21.9 | 54.2 | 145.7 | 29.7 | 23.0 | -0.1 | 6.4 | 10.2 | 13.3 | 12.7 |
| Operating margin | 14.9 | 16.0 | 19.8 | 18.2 | 18.1 | 18.7 | 19.5 | 18.7 | 19.5 | 18.7 | 20.6 |

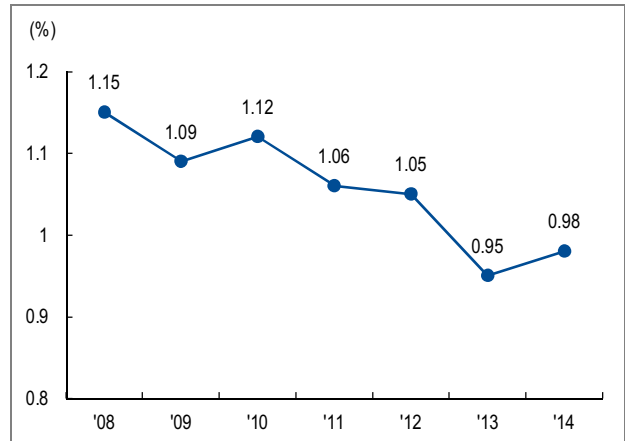
Source: Coway, NH I&S Research Center estimates

Sales growth and rental asset disposal loss



Source: Coway, NH I&S Research Center

Rental contract cancellation rate



Source: Coway, NH I&S Research Center

STATEMENT OF COMPREHENSIVE INCOME

| (Wbn) | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|---|----------|----------|----------|----------|
| Sales | 2,014 | 2,065 | 2,090 | 2,172 |
| Growth (%) | 4.1 | 2.6 | 1.2 | 3.9 |
| COGS | 673 | 673 | 686 | 709 |
| Gross Profit | 1,340 | 1,392 | 1,404 | 1,463 |
| Gross margin (%) | 66.6 | 67.4 | 67.2 | 67.4 |
| SG&A | 963 | 967 | 972 | 1,010 |
| Operating Income | 377 | 426 | 432.0 | 453 |
| Growth (%) | 13.3 | 12.7 | 1.5 | 4.9 |
| Operating margin (%) | 18.7 | 20.6 | 20.7 | 20.9 |
| EBITDA | 577 | 589 | 603 | 625 |
| Non-Operating Profits | -48 | 26 | 24 | 22 |
| Financial Income(Costs) | -9 | 16 | 16 | 16 |
| Other Non-Operating Profits | -9 | 0 | 0 | 0 |
| Gains(Losses) in Associates, Subsidiaries and JVs | -31 | 10 | 8 | 6 |
| Pre-tax Profit from Cont. Op. | 330 | 451 | 456 | 475 |
| Income Taxes | 87 | 120 | 121 | 126 |
| Profit from Continuing Op. | 243 | 332 | 335 | 349 |
| Net Profit | 243 | 332 | 335 | 349 |
| Growth (%) | -4.1 | 36.6 | 0.9 | 4.3 |
| Net margin (%) | 12.1 | 16.1 | 16.0 | 16.1 |
| Net Profit of Parent | 243 | 332 | 335 | 349 |
| Net Profit to Non-Controlling | 0 | 0 | 0 | 0 |
| Other Comprehensive Income | -8 | 0 | 0 | 0 |
| Total Comprehensive Income | 235 | 332 | 335 | 349 |

VALUATION INDEX

| | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|----------------------------|----------|----------|----------|----------|
| Price/Earning (X) | 26.7 | 21.4 | 21.2 | 20.3 |
| PER (High,X) | 30.1 | 24.6 | 24.4 | 23.4 |
| PER (Low,X) | 19.9 | 17.4 | 17.3 | 16.6 |
| Price/ Book Value (X) | 6.1 | 5.7 | 5.1 | 4.7 |
| PBR (High,X) | 6.9 | 6.6 | 5.9 | 5.5 |
| PBR (Low,X) | 4.6 | 4.7 | 4.2 | 3.9 |
| Price/ Gross Cash Flow (X) | 10.0 | 11.5 | 11.3 | 11.0 |
| Price/ Sales (X) | 3.2 | 3.4 | 3.4 | 3.3 |
| PER/ EPS growth (X) | 2.1 | 5.6 | 3.7 | -7.6 |
| PER/ EBITPS growth (X) | 4.3 | 4.7 | 3.4 | -7.6 |
| PER/ EBITDAPS growth (X) | 10.0 | 5.1 | 3.9 | -43.2 |
| EV/ EBITDA (X) | 11.4 | 11.9 | 11.4 | 10.9 |
| EV/ EBIT (X) | 17.4 | 16.4 | 15.9 | 15.0 |
| Enterprise Value (Wbn) | 6,551 | 6,995 | 6,882 | 6,793 |
| EPS CAGR (3-Yr) (%) | 12.8 | 3.8 | 5.7 | -2.7 |
| EBITPS CAGR (3-Yr) (%) | 6.3 | 4.6 | 6.3 | -2.7 |
| EBITDAPS CAGR (3-Yr) (%) | 2.7 | 4.2 | 5.5 | -0.5 |
| EBITPS (W) | 4,895 | 5,518 | 5,602 | 5,876 |
| EBITDAPS (W) | 7,482 | 7,632 | 7,813 | 8,098 |
| Fully diluted EPS (W) | 3,150 | 4,303 | 4,342 | 4,526 |
| BVPS (W) | 13,732 | 16,109 | 17,901 | 19,374 |
| CFPS (W) | 8,462 | 8,021 | 8,150 | 8,397 |
| Sales PS (W) | 26,109 | 26,780 | 27,100 | 28,168 |
| DPS (W) | 2,000 | 2,000 | 2,648 | 3,173 |

CASH FLOW STATEMENT

| (Wbn) | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|---------------------------------------|----------|----------|----------|----------|
| Operating Cash Flow | 498 | 500 | 462 | 463 |
| Net Profit | 243 | 332 | 335 | 349 |
| Depreciation&Amortization | 200 | 163 | 171 | 171 |
| + Loss(Gains) from Subs | 31 | 0 | 0 | 0 |
| + FC translation loss(profit) | -4 | 0 | 0 | 0 |
| + Losses(Gains) on Disposal of Assets | 40 | 0 | 0 | 0 |
| Gross Cash Flow | 653 | 619 | 629 | 648 |
| - Incr. (Decr.) in WC | -57 | 1 | -45 | -59 |
| Investing Cash Flow | -269 | -188 | -194 | -169 |
| + Decr. In Tangible Assets | 8 | 0 | 0 | 0 |
| - Incr. In Tangible Assets(CAPEX) | -276 | -178 | -196 | -172 |
| + Disp.(Acq.) of Inv. Assets | 31 | -2 | -2 | -2 |
| Free Cash Flow | 223 | 322 | 266 | 290 |
| Net Cash Flow | 230 | 312 | 268 | 294 |
| Financing Cash Flow | -325 | -148 | -148 | -197 |
| Equity Financing | 0 | 0 | 0 | 0 |
| Debt Financing | -325 | -148 | -148 | -197 |
| Incr.(Decr.) in Cash | -96 | 164 | 120 | 97 |
| Ending Cash and Cash Equivalents | 106 | 269 | 389 | 487 |
| Net Debt (Cash) | 57 | -100 | -213 | -303 |

RIM & EVA

| | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|------------------------------------|----------|----------|----------|----------|
| RIM | | | | |
| Spread (FROE-COE) (%) | 16.4 | 22.6 | 18.9 | 17.6 |
| Residual Income | 166.5 | 260.5 | 253.5 | 260.0 |
| 12M RIM Target Price (W) | 104,683 | | | |
| EVA | | | | |
| Invested Capital | 1,018.6 | 1,044.3 | 1,069.3 | 1,092.4 |
| NOPAT | 280.9 | 313.6 | 318.3 | 334.0 |
| ROIC (%) | 28.5 | 30.4 | 30.1 | 30.9 |
| ROIC - WACC (%) | 22.3 | 25.2 | 24.6 | 25.3 |
| EVA | 227.6 | 263.0 | 262.9 | 276.2 |
| DCF | | | | |
| EBIT | 377.5 | 425.6 | 432.0 | 453.2 |
| + Depreciation/Amortization | 200 | 163 | 171 | 171 |
| - CAPEX | -275.7 | -178.4 | -196.4 | -172.4 |
| - Incr. (Decr.) in Working Capital | -31.1 | -0.3 | 0.9 | -22.0 |
| Free Cash Flow for Firm | 233.1 | 297.8 | 290.8 | 354.1 |
| WACC | | | | |
| Cost of Debt (Tax Adj.) | 3.3 | 2.9 | 2.9 | 2.9 |
| Cost of Equity (COE) | 7.5 | 6.2 | 6.6 | 6.7 |
| WACC (%) | 6.2 | 5.2 | 5.5 | 5.6 |

STATEMENT OF FINANCIAL POSITION

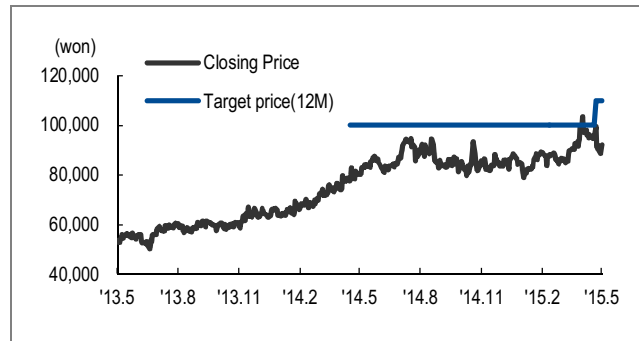
| (Wbn) | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|----------------------------------|----------|----------|----------|----------|
| Cash and Cash Equivalents | 106 | 269 | 389 | 487 |
| Accounts Receivables | 274 | 277 | 280 | 291 |
| Total Current Assets | 573 | 753 | 887 | 1,008 |
| Tangible Assets | 618 | 636 | 665 | 669 |
| Investment Assets | 123 | 125 | 128 | 130 |
| Non-Current Assets | 1,003 | 1,030 | 1,059 | 1,062 |
| Assets | 1,576 | 1,783 | 1,946 | 2,070 |
| Short-Term Debt | 163 | 170 | 177 | 184 |
| Account Payables | 47 | 49 | 51 | 52 |
| Current Liabilities | 468 | 490 | 513 | 522 |
| Long-Term Debt | 8 | 8 | 8 | 8 |
| Long-Term Allowance | 14 | 15 | 16 | 16 |
| Non-Current Liabilities | 49 | 51 | 52 | 54 |
| Liabilities | 517 | 541 | 565 | 576 |
| Capital Stock | 41 | 41 | 41 | 41 |
| Capital Surplus | 131 | 131 | 131 | 131 |
| Retained Earnings | 1,002 | 1,185 | 1,323 | 1,437 |
| Non-Controlling Interests Equity | 0 | 0 | 0 | 0 |
| Shareholders' Equity | 1,059 | 1,242 | 1,381 | 1,494 |

PROFITABILITY & STABILITY

| | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|-----------------------------|----------|----------|----------|----------|
| ROE (%) | 24.0 | 28.8 | 25.5 | 24.3 |
| ROA (%) | 15.1 | 19.8 | 18.0 | 17.4 |
| ROIC (%) | 28.5 | 30.4 | 30.1 | 30.9 |
| EBITDA/ equity (%) | 54.5 | 47.4 | 43.6 | 41.8 |
| EBITDA/ asset (%) | 36.6 | 33.0 | 31.0 | 30.2 |
| Dividend Yield (%) | 2.4 | 2.2 | 2.9 | 3.4 |
| Payout Ratio (%) | 61.1 | 44.7 | 58.7 | 67.5 |
| Total Cash Dividend (Wbn) | 148 | 148 | 197 | 236 |
| Cash DPS (W) | 2,000 | 2,000 | 2,648 | 3,173 |
| Net debt(cash)/ equity (%) | 5.4 | -8.1 | -15.4 | -20.3 |
| Debt/ equity (%) | 48.8 | 43.5 | 40.9 | 38.6 |
| Net interest exp/ sales (%) | 171 | 178 | 185 | 192 |
| Interest coverage (X) | 0.5 | 0.3 | 0.3 | 0.3 |
| Current Ratio (%) | 34.8 | 64.0 | 62.4 | 62.9 |
| Quick Ratio (%) | 122.5 | 153.6 | 173.1 | 193.2 |
| Total shares (mn) | 77 | 77 | 77 | 77 |
| Par value (W) | 500 | 500 | 500 | 500 |
| Share price (W) | 84,200 | 92,000 | 92,000 | 92,000 |
| Market Cap (Wbn) | 6,494 | 7,095 | 7,095 | 7,095 |

Rating and target price update

| Company | Code | Date | Rating | Target price |
|---------|-----------|------------|--------|---------------|
| Coway | 021240.KS | 2014.05.07 | Buy | W110,000(12M) |
| | | 2014.04.22 | Buy | W100,000(12M) |



NH Investment & Securities Stock Ratings

In order to deliver clearer investment recommendations to investors, NH Investment & Securities Research Center (as of Jan 20, 2015) will henceforth employ a three-tier rating system (Buy/Hold/Sell) rather than the previous four-tier system (Strong Buy/Buy/Hold/Reduce).

- Based on a stock's forecasted absolute return over a period of 12 months from the date of publication.
 - Buy : greater than +15%
 - Hold : -15% and +15%
 - Sell : less than -15%

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- NH I&S has not provided this material to any institutional investor or other third party in advance.
- The analyst and his/her spouse do not own any securities of 'Coway' as of the preparation date.
- This report correctly reflects the analyst's opinion and was written without any external influence or intervention.

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