

# Coway (021240)

Above
In line
Below

12M rating **BUY (Maintain)**

12M TP **W117,000** from W117,000

Up/downside **+19%**

### Stock Data

KOSPI (Aug 4, pt)	2,028
Stock price (Aug 4, KRW)	98,600
Market cap (USD mn)	6,525
Shares outstanding (mn)	77
52-Week high/low (KRW)	103,500/78,900
6M avg. daily turnover (USD mn)	13.7
Free float / Foreign ownership (%)	65.3/53.7
Major shareholders (%)	
Coway Holdings, Inc. and 9 others	31.0
NPS	6.0

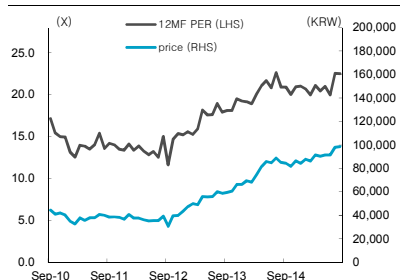
### Valuation

	2014A	2015F	2016F
PE (x)	25.1	22.5	20.3
PB (x)	5.6	5.8	5.2
ROE (%)	25.2	29.2	28.6
EV/EBITDA (x)	11.0	11.4	10.4
EPS (KRW)	3,361	4,376	4,860
BPS (KRW)	15,146	17,047	19,031

### Performance

	1M	6M	12M
Absolute (%)	8.6	11.0	11.4
Relative to KOSPI (%p)	12.2	7.7	13.9

### 12MF PE trend



Source: WISEfn consensus

## Margins improve across the board

### What's new: Solid COGS ratio improvement, no external factors

Coway posted 2Q15 OP of W110.5bn, up 14% YoY, and OPM of 19.9%, up 2.5%p YoY, in line with our estimate. Sales were down 0.3% YoY due to sluggish exports and overseas subsidiary sales, but the COGS-to-sales ratio improved 3.0%p YoY on a brisk high-margin rental business. Margin growth was catalyzed by rental-focused growth and a higher ARPU. SG&A was flat, up 0.9% YoY, on tight cost control. NP reached W82.7bn, up 25% YoY, in line with the consensus.

### Pros: Solid key indicators on rental account additions and ARPU hike

Rental sales (75% of total sales) grew 6.1% YoY while non-rental (lump-sum payments, cosmetics, exports and water treatment) sales fell 10.6% YoY. The number of total subscriber accounts reached 5.71mn, up 3.2% YoY, with ARPU climbing 2.7%. New rental sales edged down to 371,000 accounts (-0.1% YoY), and churn was stable at 1.01%. Rental account net additions reached 81,000 accounts among total account net additions of 54,000 accounts. The increase in sales of air washers (+21% YoY) and bidets (+16% YoY) was particularly robust, while water purifiers slipped from a peak in 2Q14 when exchange demand was high, but still recorded superior sales volume than 1Q15. Meanwhile, the uptick in ARPU was backed by: 1) higher rental fees, 2) a better product mix, and 3) net additions of rental accounts that generate ~70% higher ARPU than membership accounts. Going forward, the brisk rental business based on accounts should bolster 2H15 growth.

### Cons: Focus on non-rental business

Non-rental sales are flat after declining YoY over four consecutive quarters. Top-line growth is weak, while the contribution to total profit is small on a significantly lower margin than the rental business and some businesses with small operating losses. In particular, 1H15 exports slipped 29% YoY on fierce air washer competition in China. However, some businesses, including lump-sum sales, recovered growth in 1H15, and the ODM export business should enter the Chinese air washer market with diverse new products in 2H15. And, the China water purifier brand business should be visible by 2H15. Meanwhile, high growth is continuing in the US and Malaysia, where profits are becoming visible.

### Conclusion: Qualitative growth with margin improvement expected, favorable shareholder return policy

Coway is meeting growing demand for environmental home appliances fueled by

(W bn, %, %p)

	2Q15P				Change		2015F	
	KIS est.	Actual	Diff.	Consensus	QoQ	YoY	KIS	Consensus
Sales	590	555	(5.9)	590	1.3	(0.3)	2,291	2,290
OP	110	111	0.5	108	10.2	13.7	430	420
OP margin	18.6	19.9	1.3	18.3	1.6	2.5	18.8	18.4
EBT	110	109	(0.6)	106	7.7	25.9	429	415
NP	83	83	(0.1)	80	6.6	24.8	324	315

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higher income levels through its product power, services and rental business model. We believe Coway is attractive, considering: 1) margin improvement on a higher ARPU, 2) excellent cash flows, 3) high earnings visibility, and 4) attractive dividend. We maintain BUY and our TP of W117,000 (25x 12MF PE, historical peak). Dividend yield should reach 2.5% in 2015F and 2.9% in 2016F based on the current price.

Table 1. Earnings forecast

(W bn)

	2013	2014	2015F	2016F	2017F	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15P	3Q15F	4Q15F
Sales	2,118	2,160	2,263	2,436	2,629	535	557	526	543	548	555	568	591
% YoY	6.3	2.0	4.8	7.6	7.9	5.4	0.1	(0.9)	3.6	2.5	(0.3)	8.1	8.9
Rental related	1,507	1,584	1,676	1,797	1,929	386	392	400	406	409	417	423	427
% YoY	4.7	5.1	5.8	7.2	7.4	4.3	4.7	5.7	5.6	6.0	6.1	5.8	5.2
Rental	1,335	1,401	1,496	1,612	1,733	342	347	353	359	363	371	378	383
% YoY	4.5	4.9	6.8	7.8	7.5	4.6	4.5	5.3	5.8	6.1	7.1	7.1	6.9
Membership	172	183	180	184	195	44	46	47	47	46	45	45	44
% YoY	6.8	6.7	(1.8)	2.4	6.0	2.6	7.0	8.6	7.5	4.8	(0.7)	(3.8)	(7.1)
Non-Rental	439.8	432	431	468	512	109	131	97	94	101	102	109	119
% YoY	(20.6)	(29.3)	(0.2)	8.7	9.3	14.1	7.0	(13.1)	(5.9)	(7.0)	(22.4)	13.4	26.8
Lump sum payment	149	124	136	151	171	28	37	32	27	30	41	35	29
% YoY	22.4	(17.3)	9.9	11.5	12.9	(24.6)	(21.7)	(10.4)	(9.1)	8.8	10.7	10.0	9.8
Cosmetics	76	80	86	93	100	21	22	17	20	23	21	19	23
% YoY	13.7	5.3	7.0	8.0	8.0	17.1	0.7	3.6	1.0	10.2	(5.2)	12.0	12.9
Export	145	167	151	166	182	45	56	33	33	33	39	40	38
% YoY	31.9	15.8	(10.0)	10.0	10.0	43.5	25.2	(13.0)	9.3	(27.0)	(30.0)	22.0	14.8
Others	56	58	58	58	58	15	15	15	14	15	15	15	13
% YoY	(18.5)	3.9	0.0	0.0	0.0	62.6	95.9	(31.1)	(31.4)	0.0	(0.0)	2.9	(3.1)
Subsidiaries	214	181	196	213	235	52	49	43	37	53	51	49	42
% YoY	3.0	(15.6)	8.3	9.0	10.3	9.0	(23.2)	(16.9)	(27.6)	2.7	5.4	12.8	14.5
Gross profit	1,397	1,434	1,539	1,651	1,777	353	369	357	355	373	385	385	396
Gross profit rate	66.0	66.4	68.0	67.8	67.6	65.9	66.3	68.0	65.3	68.0	69.3	67.8	67.0
OP	339	364	431	476	514	90	97	95	82	100	111	108	112
% YoY	49.9	7.5	18.3	10.5	7.9	29.5	18.6	(1.0)	(10.3)	11.1	13.7	13.2	37.6
OPM (%)	16.0	16.9	19.1	19.6	19.6	16.9	17.4	18.1	15.1	18.3	19.9	19.0	19.0

Source: Company data, Korea Investment &amp; Securities

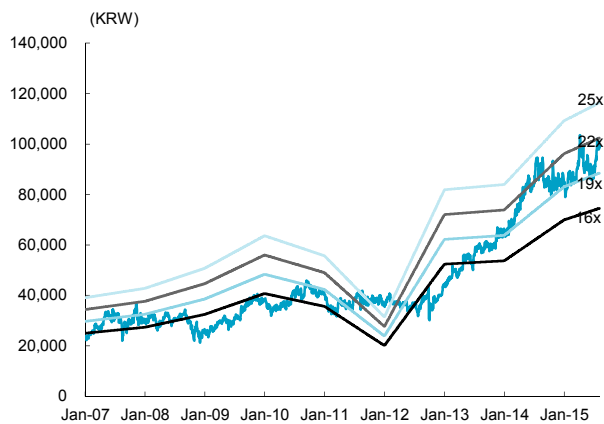
Table 2. Rental business major assumptions

(W bn, W, '000 accounts, '000 units, % YoY, %)

	2013	2014	2015F	2016F	2017F	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15P	3Q15F	4Q15F
Total no. of accounts	5,446	5,617	5,811	6,064	6,320	5,469	5,539	5,571	5,617	5,661	5,714	5,769	5,811
Increase in total no. of accounts	(36)	170	194	253	256	23	70	32	45	44	54	55	42
%YoY	(0.6)	3.1	3.5	4.4	4.2	1.8	2.7	3.0	3.1	3.5	3.2	3.6	3.5
no. of rental account ('000, year-end)	4,435	4,601	4,832	5,067	5,303	4,455	4,487	4,538	4,601	4,666	4,747	4,797	4,832
Rental account growth rate (YoY)	86	166	231	235	236	20	32	51	63	66	81	50	35
no. of membership account ('000, year-end)	1,012	1,016	979	997	1,016	1,014	1,052	1,034	1,016	994	967	972	979
Membership account growth rate (YoY)	(121)	4	(37)	18	20	2	38	(18)	(18)	(22)	(27)	5	7
No. of new rental sales ('000 units)	1,166	1,330	1,405	1,471	1,554	317	371	311	332	341	371	333	361
No. of new rental sales (%YoY)	(4.3)	14.1	5.6	4.7	5.7	(0.4)	24.3	20.8	13.5	7.5	(0.1)	7.0	8.9
Cancel rate (%)	0.95	0.99	1.02	1.02	1.04	0.97	1.04	0.96	0.94	0.96	1.01	1.00	1.01
Total monthly ARPU	22,755	23,863	24,441	25,215	25,958	23,590	23,768	23,973	24,176	24,196	24,416	24,551	24,582
%YoY	3.1	4.9	2.4	3.2	2.9	NM	2.5	2.8	2.4	2.6	2.7	2.4	1.7
Rental ARPU (Won)	25,050	25,614	26,453	27,179	27,925	25,676	25,850	26,051	26,178	26,136	26,289	26,390	26,546
Rental ARPU (%YoY)	2.5	2.2	3.3	2.7	2.7	NM	1.7	2.2	2.1	1.8	1.7	1.3	1.4
Membership ARPU (KRW)	13,358	15,073	15,044	15,548	16,175	14,441	14,757	14,905	15,253	15,253	15,429	15,501	14,890
Membership ARPU (%YoY)	6.3	12.8	(0.2)	3.3	4.0	NM	15.7	13.3	13.0	5.6	4.6	4.0	(2.4)

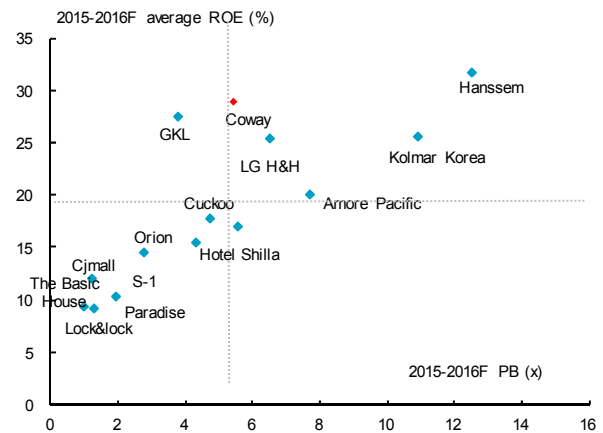
Note: On a consolidated basis; K-IFRS effective from 2011; Subscriber account standards changed effective from 2013 to exclude overdue, pending and free accounts  
Source: Company data, Korea Investment securities & Investment

Figure 1. PE band



Source: Company data, Korea Investment securities &amp; Investment

Figure 2. PB/ROE comparison with major consumer goods firms



Source: Company data, Korea Investment securities &amp; 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 5.87mn accounts (rental users + memberships) as of end-2013. 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)	2013A	2014A	2015F	2016F	2017F
Current assets	691	597	629	677	731
Cash & cash equivalent	239	147	158	170	184
Accounts & other receivables	250	229	240	258	279
Inventory	66	62	65	70	75
Non-current assets	976	1,025	1,083	1,153	1,226
Investment assets	55	55	58	62	67
Tangible assets	638	675	717	758	800
Intangible assets	177	171	179	192	208
Total assets	1,668	1,622	1,712	1,830	1,957
Current liabilities	677	526	466	426	394
Accounts & other payables	224	251	262	282	305
ST debt & bond	182	164	114	44	0
Current portion of LT debt	146	0	0	0	0
Non-current liabilities	50	56	61	65	71
Debentures	0	0	0	0	0
LT debt & financial liabilities	8	11	13	14	15
Total liabilities	727	582	526	491	465
Controlling interest	941	1,039	1,185	1,338	1,491
Capital stock	41	41	41	41	41
Capital surplus	126	126	126	126	126
Other Reserves	(94)	(114)	(114)	(114)	(114)
Retained earnings	868	986	1,133	1,285	1,438
Minority interest	0	1	1	1	1
Shareholders' equity	941	1,039	1,186	1,339	1,492

**Cash flow**

FY-ending Dec. (W bn)	2013A	2014A	2015F	2016F	2017F
C/F from operating	537	537	518	591	610
Net profit	245	250	325	361	391
Depreciation	191	206	215	224	233
Amortization	8	8	8	9	9
Net incr. in W/C	(41)	(29)	(30)	(4)	(25)
Others	134	102	0	1	2
C/F from investing	(76)	(299)	(281)	(302)	(316)
CAPEX	(268)	(306)	(266)	(275)	(285)
Decr. in fixed assets	10	10	10	10	10
Incr. in investment	180	0	(3)	(4)	(5)
Net incr. in intangible assets	(2)	(6)	(16)	(22)	(25)
Others	4	3	(6)	(11)	(11)
C/F from financing	(373)	(328)	(226)	(277)	(281)
Incr. in equity	5	5	0	0	0
Incr. in debts	(262)	(162)	(48)	(69)	(43)
Dividends	(78)	(124)	(148)	(178)	(208)
Others	(38)	(47)	(30)	(30)	(30)
C/F from others	(1)	(1)	0	0	0
Increase in cash	86	(91)	11	12	14

Note: Based on K-IFRS (consolidated)

**Income statement**

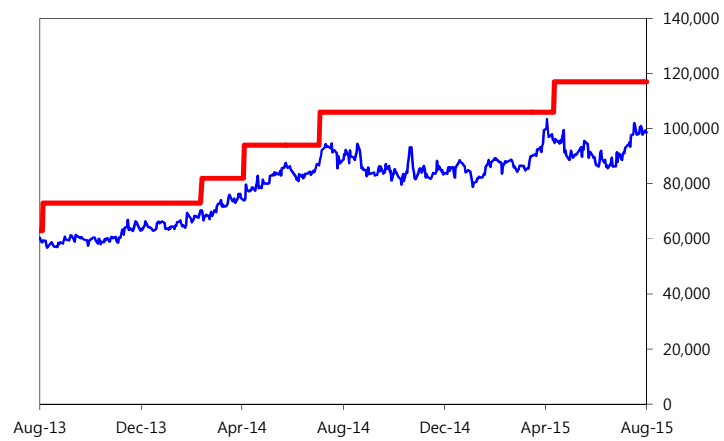
FY-ending Dec. (W bn)	2013A	2014A	2015F	2016F	2017F
Sales	2,118	2,160	2,263	2,436	2,629
COGS	721	727	724	784	852
Gross profit	1,397	1,434	1,539	1,651	1,777
SG&A expense	1,058	1,069	1,108	1,175	1,263
Operating profit	339	364	431	476	514
Financial income	4	3	2	2	3
Interest income	4	3	2	2	3
Financial expense	19	12	3	2	1
Interest expense	19	12	3	2	1
Other non-operating profit	(15)	(23)	0	2	2
Gains (Losses) in associates, subsidiaries and JV	18	0	0	0	0
Earnings before tax	327	332	430	478	517
Income taxes	82	83	105	117	127
Net profit	245	250	325	361	391
Net profit of controlling interest	245	250	325	361	391
Other comprehensive profit	(1)	(9)	0	0	0
Total comprehensive profit	244	241	325	361	391
Total comprehensive profit of controlling interest	244	241	325	361	391
EBITDA	537	578	654	709	757

**Key financial data**

FY-ending Dec.	2013A	2014A	2015F	2016F	2017F
per share data (KRW)					
EPS	3,283	3,361	4,376	4,860	5,259
BPS	13,535	15,146	17,047	19,031	21,014
DPS	2,710	2,000	2,400	2,800	3,200
Growth (%)					
Sales growth	6.3	2.0	4.8	7.6	7.9
OP growth	49.9	7.5	18.3	10.5	7.9
NP growth	160.6	1.9	30.1	11.1	8.2
EPS growth	159.1	2.4	30.2	11.1	8.2
EBITDA growth	31.1	7.6	13.2	8.4	6.7
Profitability (%)					
OP margin	16.0	16.9	19.1	19.6	19.6
NP margin	11.6	11.6	14.4	14.8	14.9
EBITDA margin	25.4	26.8	28.9	29.1	28.8
ROA	14.3	15.2	19.5	20.4	20.6
ROE	28.4	25.2	29.2	28.6	27.6
Dividend yield	4.1	2.4	2.4	2.8	3.2
Dividend payout ratio	82.4	59.4	54.9	57.6	60.8
Stability					
Net debt (W bn)	98	21	(38)	(119)	(190)
Debt/equity ratio (%)	36.5	16.8	10.7	4.3	0.1
Valuation (X)					
PE	20.2	25.1	22.5	20.3	18.7
PB	4.9	5.6	5.8	5.2	4.7
EV/EBITDA	9.5	11.0	11.4	10.4	9.6

**Changes to recommendation and price target**

Company (Code)	Date	Recommendation	Price target
Coway (021240)	08-09-13	BUY	W73,000
	02-16-14	BUY	W82,000
	04-08-14	BUY	W94,000
	07-08-14	BUY	W106,000
	04-16-15	BUY	W117,000



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BUY	Hold	Underweight (Sell)
76.6%	20.5%	2.9%

Note: % of companies under coverage with this rating

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Prepared by: Eun-chaе Na

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