

Coway (021240.KS)

Company Comment | Aug 5, 2015

Key investment points: Profitability improving and dividend yield high

Coway's 2Q15 earnings came in line with our expectations. Despite investor concerns towards growing competition affecting the health appliance division, the play successfully defended its profit levels thanks to solid sales growth at the health appliance division. We expect both the launching of a water purifier business (featuring its flagship brand 'Coway') in China and a high dividend yield (around 3% based on the current share price) to catalyze the shares in 2H15. Backed by these positives, we raise our target price to W125,000.

2Q15 results: Profit grows rapidly and at pace we expected

- On an IFRS non-consolidated basis, Coway announced 2Q15 sales of W527.5bn (up 0.8% y-y) and operating profit of W111.7bn (up 14.4% y-y), with both numbers meeting consensus and our estimates. While the firm's 2Q15 sales growth (y-y) was somewhat sluggish (attributable to a contraction at its overseas ODM business—sales started slowing in 1Q15 (sales down 55% y-y in 1Q15)), sales at the health appliance division (the company's core business) rose 6.2% y-y. In detail, the play's operating profit rose 14.4% y-y, led by sales volume growth on: 1) new product effects; and 2) strengthened channel competitiveness. Despite investor concerns towards competition affecting the health appliance division, Coway continues to secure new customers thanks to diversification of both its products and sales channels.
- The company's 2Q15 rental cancellation ratio exceeded 1%. However, considering the loss rate on rental asset disposals (rental cancellation ratio and loss rate on rental asset disposals are key profit determinants for the company), we believe that its operating profit will continue to mark solid growth going forward.

Growth catalysts: Flagship Coway business in China and favorable sales at core business

- Coway is planning to launch a water purifier business (featuring its flagship 'Coway' brand) in China. We believe that the firm will present a detailed strategic blueprint for this new venture in the near future.
- Also, the play is engaged in expanding its domestic sales channels—its products are now for sale at the electronics chain Hi-Mart and domestic duty free stores (DFSs).

Dividend yield high—catalyst for valuation hike

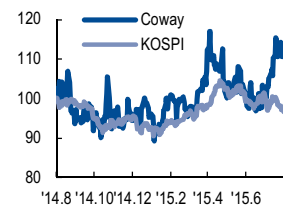
- We stick to our Buy rating and raise our target price from W110,000 to W125,000. Considering the recent sales volume growth at the company's core business, we raised our 2016 and 2017 operating profit estimates by 8~9% for each year. Our new target price is equivalent to a 2016F P/E of 26x, the same as the average for the consumer staples segment. Our upbeat assessment is based on the following: 1) Coway has a unique business model (sustainable subscriber-based rental business); 2) the firm possesses a unique earnings structure (relatively unaffected by the phase of the economic cycle); and 3) there exists anticipation towards an increase in dividends.

Buy (maintain)

TP **W125,000 (raise)**
CP ('15/08/04) **W98,600**

| Sector | Consumer goods |
|----------------------------|----------------|
| Kospi | 2,027.99 |
| Kosdaq | 730.03 |
| Market cap (common) | US\$6,505.13mn |
| Outstanding shares(common) | 77.1mn |
| 52W high ('15/04/07) | W103,500 |
| low ('15/01/08) | W78,900 |
| Average trading value(60D) | US\$11.54mn |
| Dividend yield(2014) | 2.4% |
| Foreign ownership | 53.7% |

Price trend



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| 2Q15 review | | | | | | | | | | | (Units: Wbn, %) |
|------------------|------|------|------|------|--------|------|------|----------|-----------|-------|-----------------|
| | 2Q14 | 3Q14 | 4Q14 | 1Q15 | 2Q15P | | | | | 3Q15E | |
| | | | | | Actual | y-y | q-q | Estimate | Consensus | | |
| Sales | 523 | 496 | 500 | 506 | 527 | 0.8 | 4.2 | 531 | 539 | 535 | |
| Operating profit | 98 | 97 | 93 | 99 | 112 | 14.4 | 2.5 | 109 | 107 | 112 | |
| Operating margin | 18.7 | 19.5 | 18.7 | 19.5 | 21.2 | | | 20.5 | 19.8 | 21.0 | |
| Pretax profit | 87 | 88 | 67 | 98 | 111 | 28.5 | 13.3 | 108 | 106 | 131 | |
| Net profit | 65 | 66 | 45 | 75 | 85 | 30.4 | 13.3 | 78 | 79 | 101 | |

Note: IFRS non-consolidated basis; Source: Coway, FnGuide, NH I&S research center estimates

| DCF-based target price of W125,000 | | | | | | | | | (Units: Wbn, won, %) |
|------------------------------------|----------------|-------|-------|-------|-------|-------|-------|--------------------------|----------------------|
| | 2014 | 2015E | 2016F | 2017F | 2018F | 2019F | 2020F | | |
| EBIT | 377 | 426 | 479 | 513 | 640 | 685 | 692 | | |
| NOPLAT | 281 | 314 | 353 | 378 | 471 | 504 | 509 | | |
| DEP+AMOR | 200 | 163 | 179 | 189 | 198 | 209 | 220 | | |
| CAPEX | 276 | 178 | 238 | 224 | 231 | 249 | 256 | | |
| FCF | 233 | 305 | 291 | 350 | 452 | 476 | 481 | | |
| Discount factor | | 0.94 | 0.88 | 0.83 | 0.78 | 0.73 | 0.68 | | |
| PV of FCF | | 286 | 256 | 289 | 351 | 347 | 328 | | |
| Sum of PV | 1,857 | | | | | | | | |
| Continuing Value | | | | | | | | | |
| Noplat as of 2019 | 509 | | | | | | | [Key assumptions] | |
| g | 2.0 | | | | | | | g=2.0% | |
| ROIC | 29.9 | | | | | | | Rf=4.0% | |
| CV at the end of 2019 | 10,753 | | | | | | | Rp=6.0% | |
| discount factor | 0.68 | | | | | | | Beta=0.7 | |
| PV of Continuing Value | 7,346 | | | | | | | | |
| Equity Value | 9,260 | | | | | | | | |
| +net debt | 57 | | | | | | | | |
| -minority interest | 0 | | | | | | | | |
| -Preferred Stock | 0 | | | | | | | | |
| mid-year adjust factor | 1.04 | | | | | | | | |
| Current Equity Value | 9,619 | | | | | | | | |
| Per share Value | 125,000 | | | | | | | | |
| shares outstanding | 77,125 | | | | | | | | |
| Present price | 98,600 | | | | | | | | |
| Upside (%) | 26.8 | | | | | | | | |

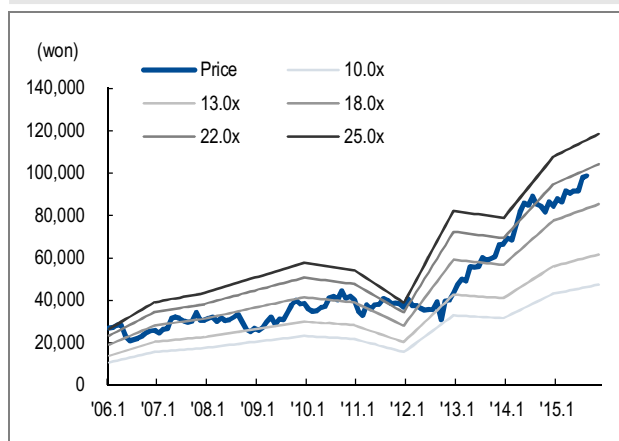
Source: NH I&S Research Center estimates

| Earnings forecasts (IFRS non-consolidated) | | | | | | (Units: Wbn, won, x, %) |
|--|------------|---------|---------|---------|---------|-------------------------|
| | | 2014 | 2015E | 2016F | 2017F | |
| Sales | - Revised | 2,013.6 | 2,111.3 | 2,240.5 | 2,343.9 | |
| | - Previous | | 2,065.4 | 2,090.1 | 2,172.5 | |
| | - Change | | | 2.2 | 7.2 | 7.9 |
| Operating profit | - Revised | 377.5 | 426.4 | 479.1 | 512.8 | |
| | - Previous | | 425.6 | 442.5 | 470.6 | |
| | - Change | | | 0.2 | 8.3 | 9.0 |
| Operating margin (revised) | | | 20.2 | 21.4 | 21.9 | |
| EBITDA | | 577.0 | 589.4 | 658.4 | 702.0 | |
| Net profit (excl minority interests) | | 242.9 | 332.0 | 368.3 | 391.3 | |
| EPS | - Revised | 3,150 | 4,305 | 4,775 | 5,074 | |
| | - Previous | | 4,298 | 4,429 | 4,677 | |
| | - Change | | | 0.2 | 7.8 | 8.5 |
| P/E | | 26.7 | 22.9 | 20.6 | 19.4 | |
| P/B | | 6.1 | 6.4 | 5.8 | 5.4 | |
| EV/EBITDA | | 11.4 | 12.9 | 11.4 | 10.6 | |
| ROE | | 24.0 | 29.5 | 29.5 | 28.7 | |

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

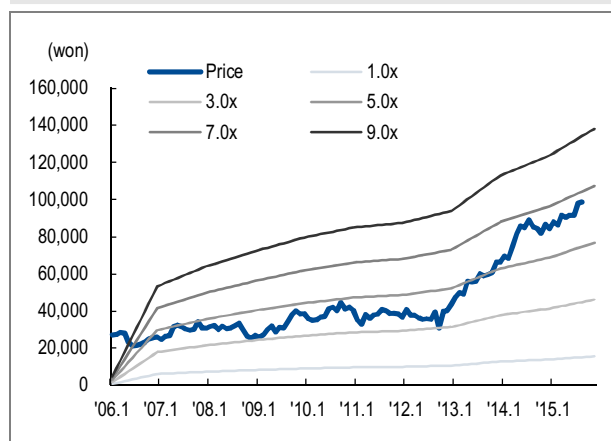
Source: NH I&S Research Center estimates

Forward P/E band



Source: DataGuide Pro

Trailing P/B band



Source: DataGuide Pro

Earnings forecasts

(Units: Wbn, %)

| | 1Q14 | 2Q14 | 3Q14 | 4Q14 | 1Q15 | 2Q15P | 3Q15E | 4Q15F | 2014 | 2015E | 2016F |
|-------------------------|------------|------------|------------|------------|------------|------------|------------|------------|--------------|--------------|--------------|
| Sales | 495 | 523 | 496 | 500 | 506 | 527 | 535 | 543 | 2,014 | 2,111 | 2,241 |
| Rental | 342 | 347 | 353 | 359 | 363 | 387 | 394 | 401 | 1,401 | 1,546 | 1,634 |
| Membership | 44 | 46 | 47 | 47 | 46 | 45 | 49 | 50 | 183 | 191 | 202 |
| Lump-sum sales | 26 | 37 | 32 | 27 | 30 | 41 | 32 | 27 | 122 | 131 | 137 |
| Exports | 45 | 56 | 33 | 33 | 33 | 39 | 30 | 30 | 167 | 132 | 136 |
| Cosmetics | 21 | 22 | 17 | 20 | 23 | 21 | 15 | 21 | 80 | 80 | 83 |
| Other | 15 | 15 | 15 | 14 | 11 | 9 | 15 | 14 | 58 | 48 | 48 |
| Sales growth | 6.4 | 5.3 | 1.4 | 3.6 | 2.3 | 0.8 | 7.9 | 8.6 | 4.1 | 4.9 | 6.1 |
| Rental | 4.6 | 4.5 | 5.3 | 5.8 | 6.1 | 11.7 | 11.8 | 11.7 | 5.0 | 10.4 | 5.7 |
| Membership | 2.6 | 7.0 | 8.6 | 7.4 | 4.9 | -0.8 | 4.5 | 7.0 | 6.4 | 3.9 | 6.2 |
| Lump-sum sales | -29.6 | -21.8 | -10.4 | -9.1 | 16.4 | 10.7 | 1.5 | 1.5 | -18.5 | 7.5 | 5.0 |
| Exports | 43.6 | 25.1 | -13.0 | 9.3 | -27.0 | -30.0 | -10.0 | -10.0 | 15.8 | -21.2 | 3.0 |
| Cosmetics | 17.4 | 0.5 | 3.6 | 1.1 | 10.5 | -5.3 | -10.0 | 3.0 | 5.3 | -0.1 | 3.0 |
| Other | 63.4 | 98.4 | -31.0 | -31.1 | -28.2 | -38.6 | 0.0 | 0.0 | 1.1 | -17.3 | 0.0 |
| Gross profit | 326 | 343 | 334 | 338 | 347 | 361 | 361 | 367 | 1,340 | 1,436 | 1,516 |
| Gross margin | 65.8 | 65.5 | 67.2 | 67.7 | 68.5 | 68.4 | 67.4 | 67.7 | 66.6 | 68.0 | 67.7 |
| Operating profit | 90 | 98 | 97 | 93 | 99 | 112 | 112 | 103 | 377 | 426 | 479 |
| Growth | 29.7 | 23.0 | -0.1 | 6.4 | 10.2 | 14.4 | 15.8 | 11.1 | 13.3 | 13.0 | 12.4 |
| Operating margin | 18.1 | 18.7 | 19.5 | 18.7 | 19.5 | 21.2 | 21.0 | 19.1 | 18.7 | 20.2 | 21.4 |

Source: Coway, NH I&S Research Center estimates

STATEMENT OF COMPREHENSIVE INCOME

| (Wbn) | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|---|----------|----------|----------|----------|
| Sales | 2,014 | 2,111 | 2,241 | 2,344 |
| Growth (%) | 4.1 | 4.9 | 6.1 | 4.6 |
| COGS | 673 | 676 | 724 | 753 |
| Gross Profit | 1,340 | 1,436 | 1,516 | 1,591 |
| Gross margin (%) | 66.6 | 68.0 | 67.7 | 67.9 |
| SG&A | 963 | 1,009 | 1,037 | 1,078 |
| Operating Income | 377 | 426 | 479 | 513 |
| Growth (%) | 13.3 | 13.0 | 12.4 | 7.0 |
| Operating margin (%) | 18.7 | 20.2 | 21.4 | 21.9 |
| EBITDA | 577 | 589 | 658 | 702 |
| Non-Operating Profits | -48 | 25 | 22 | 20 |
| Financial Income(Costs) | -9 | 15 | 14 | 14 |
| 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 | 452 | 501 | 532 |
| Income Taxes | 87 | 120 | 133 | 141 |
| Profit from Continuing Op. | 243 | 332 | 368 | 391 |
| Net Profit | 243 | 332 | 368 | 391 |
| Growth (%) | -4.1 | 36.7 | 10.9 | 6.3 |
| Net margin (%) | 12.1 | 15.7 | 16.4 | 16.7 |
| Net Profit of Parent | 243 | 332 | 368 | 391 |
| Net Profit to Non-Controlling | 0 | 0 | 0 | 0 |
| Other Comprehensive Income | -8 | 0 | 0 | 0 |
| Total Comprehensive Income | 235 | 332 | 368 | 391 |

CASH FLOW STATEMENT

| (Wbn) | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|---------------------------------------|----------|----------|----------|----------|
| Operating Cash Flow | 498 | 446 | 497 | 551 |
| Net Profit | 243 | 332 | 368 | 391 |
| Depreciation&Amortization | 200 | 163 | 179 | 189 |
| + 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 | 684 | 725 |
| - Incr. (Decr.) in WC | -57 | -54 | -55 | -33 |
| Investing Cash Flow | -269 | -220 | -238 | -223 |
| + Decr. In Tangible Assets | 8 | 0 | 0 | 0 |
| - Incr. In Tangible Assets(CAPEX) | -276 | -178 | -238 | -224 |
| + Disp.(Acq.) of Inv. Assets | 31 | -2 | -2 | -2 |
| Free Cash Flow | 223 | 268 | 258 | 327 |
| Net Cash Flow | 230 | 226 | 259 | 328 |
| Financing Cash Flow | -325 | -147 | -197 | -255 |
| Equity Financing | 0 | 0 | 0 | 0 |
| Debt Financing | -325 | -147 | -197 | -255 |
| Incr.(Decr.) in Cash | -96 | 79 | 62 | 73 |
| Ending Cash and Cash Equivalents | 106 | 185 | 247 | 320 |
| Net Debt (Cash) | 57 | -15 | -70 | -136 |

STATEMENT OF FINANCIAL POSITION

| (Wbn) | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|----------------------------------|----------|----------|----------|----------|
| Cash and Cash Equivalents | 106 | 185 | 247 | 320 |
| Accounts Receivables | 274 | 283 | 300 | 314 |
| Total Current Assets | 573 | 674 | 768 | 868 |
| Tangible Assets | 618 | 636 | 699 | 736 |
| Investment Assets | 123 | 125 | 128 | 130 |
| Non-Current Assets | 1,003 | 1,062 | 1,123 | 1,161 |
| Assets | 1,576 | 1,736 | 1,891 | 2,029 |
| Short-Term Debt | 163 | 170 | 177 | 184 |
| Account Payables | 47 | 49 | 54 | 57 |
| Current Liabilities | 468 | 490 | 530 | 558 |
| Long-Term Debt | 8 | 9 | 9 | 9 |
| Long-Term Allowance | 14 | 15 | 16 | 16 |
| Non-Current Liabilities | 49 | 52 | 54 | 55 |
| Liabilities | 517 | 542 | 584 | 613 |
| Capital Stock | 41 | 41 | 41 | 41 |
| Capital Surplus | 131 | 131 | 131 | 131 |
| Retained Earnings | 1,002 | 1,137 | 1,250 | 1,358 |
| Non-Controlling Interests Equity | 0 | 0 | 0 | 0 |
| Shareholders' Equity | 1,059 | 1,194 | 1,307 | 1,416 |

VALUATION INDEX

| | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|----------------------------|----------|----------|----------|----------|
| Price/Earning (X) | 26.7 | 22.9 | 20.6 | 19.4 |
| PER (High,X) | 30.1 | 24.6 | 22.2 | 20.9 |
| PER (Low,X) | 19.9 | 17.4 | 15.7 | 14.8 |
| Price/ Book Value (X) | 6.1 | 6.4 | 5.8 | 5.4 |
| PBR (High,X) | 6.9 | 6.8 | 6.3 | 5.8 |
| PBR (Low,X) | 4.6 | 4.8 | 4.4 | 4.1 |
| Price/ Gross Cash Flow (X) | 10.0 | 12.3 | 11.1 | 10.5 |
| Price/ Sales (X) | 3.2 | 3.6 | 3.4 | 3.2 |
| PER/ EPS growth (X) | 1.6 | 1.7 | 1.7 | 1.9 |
| PER/ EBITPS growth (X) | 2.5 | 1.6 | 1.6 | 1.9 |
| PER/ EBITDAPS growth (X) | 4.0 | 1.8 | 1.9 | 2.1 |
| EV/ EBITDA (X) | 11.4 | 12.9 | 11.4 | 10.6 |
| EV/ EBIT (X) | 17.4 | 17.8 | 15.7 | 14.6 |
| Enterprise Value (Wbn) | 6,551 | 7,589 | 7,534 | 7,468 |
| EPS CAGR (3-Yr) (%) | 17.2 | 13.3 | 11.9 | 10.1 |
| EBITPS CAGR (3-Yr) (%) | 10.8 | 14.5 | 12.6 | 10.5 |
| EBITDAPS CAGR (3-Yr) (%) | 6.8 | 12.5 | 10.7 | 9.1 |
| EBITPS (W) | 4,895 | 5,528 | 6,211 | 6,649 |
| EBITDAPS (W) | 7,482 | 7,642 | 8,537 | 9,102 |
| Fully diluted EPS (W) | 3,150 | 4,305 | 4,775 | 5,074 |
| BVPS (W) | 13,732 | 15,483 | 16,947 | 18,356 |
| CFPS (W) | 8,462 | 8,031 | 8,874 | 9,400 |
| Sales PS (W) | 26,109 | 27,376 | 29,051 | 30,391 |
| DPS (W) | 2,000 | 2,652 | 3,438 | 3,806 |

RIM & EVA

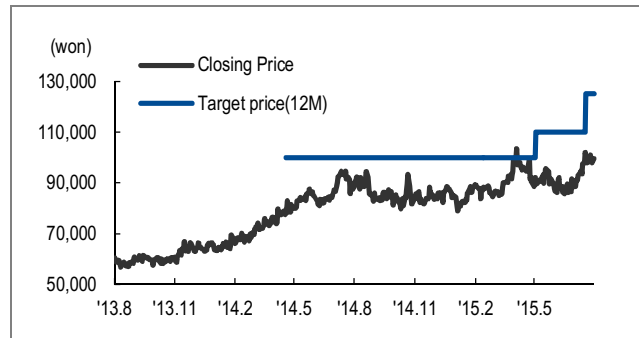
| | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|------------------------------------|----------|----------|----------|----------|
| RIM | | | | |
| Spread (FROE-COE) (%) | 16.4 | 21.3 | 22.9 | 22.1 |
| Residual Income | 166.5 | 262.2 | 290.8 | 306.9 |
| 12M RIM Target Price (W) | 118,769 | | | |
| EVA | | | | |
| Invested Capital | 1,018.6 | 1,082.2 | 1,139.5 | 1,181.9 |
| NOPAT | 280.9 | 314.2 | 352.9 | 377.7 |
| ROIC (%) | 28.5 | 29.9 | 31.8 | 32.5 |
| ROIC - WACC (%) | 22.3 | 23.4 | 26.3 | 27.0 |
| EVA | 227.6 | 252.7 | 299.7 | 319.3 |
| DCF | | | | |
| EBIT | 377.5 | 426.4 | 479.1 | 512.8 |
| + Depreciation/Amortization | 200 | 163 | 179 | 189 |
| - CAPEX | -275.7 | -178.4 | -238.5 | -224.1 |
| - Incr. (Decr.) in Working Capital | -31.1 | -6.7 | 1.8 | -7.6 |
| Free Cash Flow for Firm | 233.1 | 304.7 | 291.2 | 349.6 |
| WACC | | | | |
| Cost of Debt (Tax Adj.) | 3.3 | 2.9 | 2.9 | 2.9 |
| Cost of Equity (COE) | 7.5 | 8.2 | 6.6 | 6.7 |
| WACC (%) | 6.2 | 6.6 | 5.5 | 5.5 |

PROFITABILITY & STABILITY

| | 2014/12A | 2015/12E | 2016/12F | 2017/12F |
|-----------------------------|----------|----------|----------|----------|
| ROE (%) | 24.0 | 29.5 | 29.5 | 28.7 |
| ROA (%) | 15.1 | 20.0 | 20.3 | 20.0 |
| ROIC (%) | 28.5 | 29.9 | 31.8 | 32.5 |
| EBITDA/ equity (%) | 54.5 | 49.4 | 50.4 | 49.6 |
| EBITDA/ asset (%) | 36.6 | 34.0 | 34.8 | 34.6 |
| Dividend Yield (%) | 2.4 | 2.7 | 3.5 | 3.9 |
| Payout Ratio (%) | 61.1 | 59.3 | 69.3 | 72.2 |
| Total Cash Dividend (Wbn) | 148 | 197 | 255 | 283 |
| Cash DPS (W) | 2,000 | 2,652 | 3,438 | 3,806 |
| Net debt(cash)/ equity (%) | 5.4 | -1.3 | -5.4 | -9.6 |
| Debt/ equity (%) | 48.8 | 45.4 | 44.7 | 43.3 |
| Net interest exp/ sales (%) | 171 | 179 | 186 | 193 |
| Interest coverage (X) | 0.5 | 0.3 | 0.3 | 0.3 |
| Current Ratio (%) | 34.8 | 64.1 | 69.2 | 71.1 |
| Quick Ratio (%) | 122.5 | 137.6 | 144.8 | 155.7 |
| Total shares (mn) | 77 | 77 | 77 | 77 |
| Par value (W) | 500 | 500 | 500 | 500 |
| Share price (W) | 84,200 | 98,600 | 98,600 | 98,600 |
| Market Cap (Wbn) | 6,494 | 7,605 | 7,605 | 7,605 |

Rating and target price update

| Company | Code | Date | Rating | Target price |
|---------|-----------|------------|--------|---------------|
| Coway | 021240.KS | 2015.08.05 | Buy | W125,000(12M) |
| | | 2015.05.07 | Buy | W110,000(12M) |
| | | 2014.04.22 | Buy | W100,000(12M) |



NH Investment & Securities Stock Ratings

1. Rating 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% to +15%
- Sell: Less than -15%

2. Regarding listed companies under NH I&S' coverage, our stock ratings break down as follows (as of Jul 31, 2015).

• NH I&S' stock rating distribution

| Buy | Hold | Sell |
|-------|-------|------|
| 69.2% | 29.2% | 1.6% |

- The stock rating on an individual company can change at irregular intervals. Our stock rating distribution is calculated on a weekly basis.

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- 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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