SMART ON

Coway (021240)

BUY (initiate)

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Other Consumer Goods
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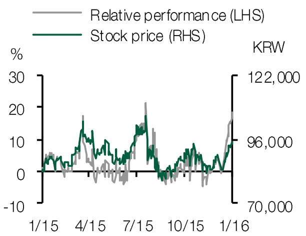
Current price (Jan 20)	KRW94,300
Target Price	KRW110,000
Reuters code	021240.KS
Bloomberg code	021240 KS
Industry/Sector	Other Consumer Services
Rating	
Market cap	USD6.0bn
Ordinary shares issued	77,124,796shrs
Free float	65.4%
KOSPI	1,845.45
KOSDAQ	669.68
Avg T/O Vol (60d)	166,925shrs
Avg T/O Val (60d)	12.1mn
Foreign ownership	52.7%
3yr CAGR of adj EPS (15~17)	13.5%
Market's 3yr CAGR of adj. EPS	22.4%
52wk high/low	KRW105,500
	KRW79,200
Beta (12M, daily return)	0.7
Major shareholders	Coway Holdings, Inc. and 9 others
	31.0%

Price performance	1M	3M	6M
Absolute	8.5%	4.2%	−3.8%
Relative	16.2%	15.1%	8.1%



Growth Continues As Practical Consumption Trend Spreads

Korea's biggest home appliance rental company

Coway, Korea's biggest home appliance rental company (major products represent 40−60% market share) is mainly engaged in rental and lump−sum payment−based sales of products, such as water purifiers, air cleaners, bidets and mattresses. Wellness home appliances, overseas businesses, cosmetics and water environment businesses account for 86%, 8%, 4% and 2% of sales, respectively, as of 2014. The company is benefiting from the spread of a practical consumption culture, where economic feasibility and functional value are highly considered.

Steady growth likely to continue, driven by rapid penetration of sharing economy and spread of practical consumption trend

The sharing economy and the spreading practical consumption trend are beginning to catch on in Korea. The rental service business is an optimized market for such changes in consumption patterns. The domestic B2C rental service market has grown at a CAGR of 12% to approximately KRW15tr. Coway, the No. 1 player in the domestic wellness home appliance rental service market, is projected to grow continuously. Coway is forecast to: 1) generate stable cash flows based on the growth of its rental business and 2) secure additional growth momentum via overseas markets and new businesses. Moreover, Coway is expected to sustain its shareholder return policy via profitability−oriented operations and dividend payments. There are unsettling noises (e.g., majority shareholder's potential stake disposal), but Coway is expected to exhibit differentiated growth based on stable cash flow stemming from its solid business model.

Coverage initiated with BUY rating and target price of KRW110,000

We initiate our coverage of Coway with a BUY rating and a target price of KRW110,000. As we surmise that the business model can generate stable cash flow and sustain growth over the long term, the target price was computed based on a DCF model (WACC=7%, Rf=2.7%, risk premium=6.5%, market beta=0.7). The issue of a potential stake disposal by the majority shareholder is a short−term downside factor, but Coway is expected to exhibit a sound share price trend over the long term.

FY−end	12/13A	12/14A	12/15F	12/16F	12/17F
(Reporting standard)	(IFRS−C)	(IFRS−C)	(IFRS−C)	(IFRS−C)	(IFRS−C)
OR (KRWbn)	2,118.3	2,160.3	2,267.7	2,413.6	2,535.5
OP (KRWbn)	339.0	364.4	440.0	462.4	487.9
NP (KRWbn)	245.1	249.7	329.8	346.0	365.3
Parent NP (KRWbn)	245.1	249.7	329.9	346.0	365.3
EPS (KRW)	3,288	3,360	4,443	4,657	4,917
Adj. EPS (KRW)	3,288	3,360	4,443	4,657	4,917
PER* (x)	20.5−13.1	28.2−18.7	24.1−16.9	20.2	19.2
PBR (x)	5.3	6.0	5.1	5.1	4.5
EV/EBITDA (x)	9.7	11.3	9.6	10.3	9.9
Div. Yield (%)	4.1	2.4	3.0	2.9	3.1
ROE (%)	28.4	25.2	29.2	26.5	24.9
ROIC (%)	25.1	27.3	31.9	31.0	29.5

Note: IFRS−C = Consolidated financial statements; IFRS−P = Individual financial statements *Source: Company data, Hyundai Securities*

Investment Points and Valuation

Direct beneficiary of growing rental service market amid spread of rational consumption trend

Rational consumption is here to stay amid a recession in the domestic economy. The rental service business is an optimized market to such changes in consumption patterns. The domestic B2C rental service market has grown at a CAGR of 12% to approximately KRW15tr. Coway, the No. 1 player in the domestic wellness home appliance rental service market, is projected to grow continuously.

Investment point:
1) Growth in rental service business, 2) momentum from overseas markets and new business, 3) profitability-oriented operations, and 4) shareholder-friendly policy

Coway's investment points are as follows. Coway is forecast to: 1) generate stable cash flow based on a growing wellness home appliance rental business in Korea, 2) secure additional growth momentum via overseas markets and new businesses, and 3) sustain its shareholder-friendly policy (e.g., profitability-oriented operations, dividend payments). There are unsettling noises (e.g., majority shareholder's potential stake disposal), but Coway is expected to exhibit differentiated growth based on stable cash flow stemming from its solid business model.

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Fig 1: Target price calculated through DCF

(KRWbn)	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F
OP	440.1	462.4	487.9	509.4	540.2	548.7	603.6	663.9	730.3	803.4
Income tax rate	24.2%	24.2%	24.2%	24.2%	24.2%	24.2%	24.2%	24.2%	24.2%	24.2%
OP after tax (NOPLAT)	333.6	350.5	369.8	386.1	409.5	415.9	457.5	503.3	553.6	609.0
Depreciation expenses/intangible asset expenses	227.6	230.5	230.2	231.4	232.5	233.7	234.9	236.0	237.2	238.4
Increase in working capital	(9.0)	13.6	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
CAPEX	(244.7)	(300.0)	(320.0)	(323.2)	(326.4)	(329.7)	(329.7)	(329.7)	(329.7)	(329.7)
FCF	307.5	294.7	290.0	304.3	325.6	329.9	372.7	419.6	471.1	527.7
Discount factor	1.07	1.14	1.23	1.31	1.40	1.50	1.61	1.72	1.84	1.97
FCF (present value)	287.3	257.4	236.7	232.1	232.1	219.8	232.1	244.2	256.3	268.2
WACC	7.0%									
FCF's current value	2,466.4									
Residual value	5,472.0									
Enterprise value	7,938.4									
Net debt	181.8									
Shareholders' equity	8,120									
# of shares (share)	74,297,159									
Target price (KRW)	109,293									
Calculation of residual value										
FCF (terminal year)	527.7									
WACC	7.0%									
Terminal growth	2.0%									
Residual value	5,472.0									

Source: Company data, Hyundai Securities

Domestic Business (Wellness Home Appliances)

Spreading of consumption culture focused on sharing economy (e.g., rental) amid rational consumption trends in domestic consumer market

Rational consumption is here to stay, as domestic consumer sentiment deteriorates. Rational consumption means the reduction of unnecessary expenditures and use of necessary products and services at affordable prices. Rational consumption choices became essential when it comes to daily necessities. As economic factors become key points of consideration in spending, consumers began to pursue a practical consumption patter with sharing in focus rather than possession. This is underpinning the growth of the domestic rental market.

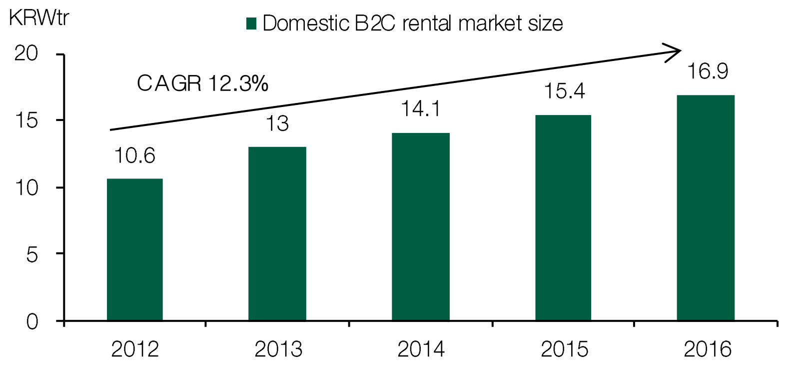
Shift in domestic rental market: Low quality products at cheap prices → high quality for required periods

The domestic rental market has spread to various industries. We now live in a world where anything can be rented from houses, cars, home appliances and even tires. Previously, the prevailing view about rental products was that they were low in quality or involved services that are available at cheap prices for a short period of time, but currently, renting has become a part of rational consumption patterns, using quality products at lower prices for required periods.

Domestic B2C rental market valued at KRW15tr; suggesting CAGR of 13% over past four years

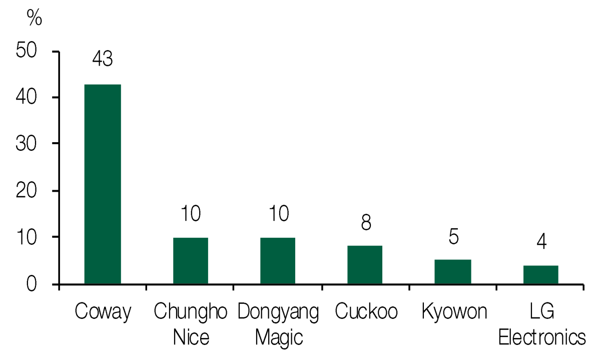
The domestic rental market has been exhibiting lofty growth as it began to satisfy needs that were created amid the economic recession, coincide with the changed awareness of consumers, while a wider range of products became available. The domestic rental market displayed a CAGR of 13% over the past four years amid a changing consumption culture and is projected to balloon to KRW17tr in 2016.

Fig 2: Domestic B2C rental market expected to reach KRW17tr by 2016



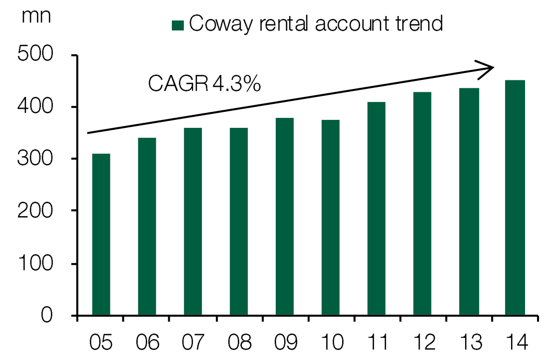
Source: DIGIECO, Hyundai Securities

Fig 3: Dominant market share of Coway's water purifiers



Source: Company data, Media reports, Hyundai Securities

Fig 4: Stable rental account growth



Source: Company data, Hyundai Securities

Aftercare capabilities are essential to rental companies; Coway is at top of industry in terms of management capabilities, with 40% re-rental rate, 37% membership (care service) subscription rate and 23% termination rate

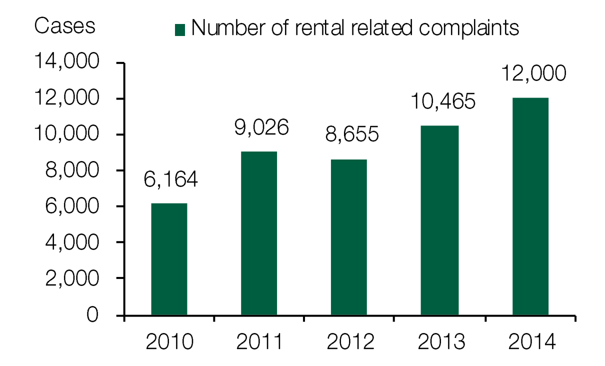
Aftercare capabilities are as important as account holdings for rental companies. Thorough client and aftercare management are essential, because every year about 560,000 account holders must decide whether to stop their rental contracts and gain ownership rights to the products they had been renting. The clients are entitled to ownership rights for products after obligatory five-year rental period. Usually, 40% of clients opt to renew their rental contracts by replacing existing products with new ones, 37% subscribe to membership (care service for existing products) or 23% terminate the contracts. If rental companies lose a customer base, which has been established based on long-time experiences and know-how, due to customer dissatisfaction with products or services, it will wreak irreparable havoc on them. Yet, Coway is effectively managing its customers based on its superb follow-up service capabilities.

Key indicators of customer management: Re-rental rate, cancellation rate, and obsolescence losses on rental assets

Coway's re-rental rate stands at 40%, cancellation rate at about 1%, obsolescence losses on rental assets at about 2-3% of rental revenues (top-level among peers)

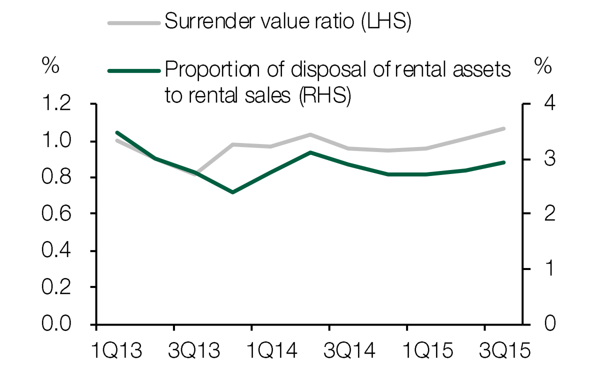
Indicators of Coway's customer management capabilities are its re-rental rate, cancellation rate, and obsolescence losses on rental assets. According to the Korea Consumer Protection Board, rental-related customer complaints grew at a CAGR of 18% from 7,000 in 2012 to 8,000 in 2013 and 9,700 in 2014. On the other hand, Coway has maintained its cancellation rate at around 1% based on its superb product management and services. Coway has maintained its retention rate at 77% (i.e., the combined proportion of customers, who: 1) shift into membership services by securing ownership of rental products or 2) sign re-rental contracts by using new rental products). Although re-rental customers are exempt from registration fees as part of marketing efforts, it seems to be appropriate economic benefits to long-term customers. Lastly, obsolescence losses on rental assets are kept stable at the range of 2.5-3.5% of total rental revenues. Obsolescence losses on rental assets refer to losses stemming from customers' cancelling their services before the expiry of a contract term (five years) and a consequent return of rental products. Obsolescence losses are correlated with a cancellation rate. As Coway's cancellation rate is continuously maintained, its obsolescence losses are also kept at low levels.

Fig 5: Number of rental related complaint trend



Source: KCA, Hyundai Securities

Fig 6: Surrender ratio and rental asset disposal efficently managed



Source: Company data, Hyundai Securities

Defending market share and securing new customers through product expansion of flagship water purifiers

The company deals with various products including air purifiers, bidets and water softeners as well as water purifiers. It also sells vacuums cleaners, massage chairs and Juicepresso machines for lump-sum payments. Although water purifier sales represent 48% of total rental sales and sales are still highly dependent on water purifiers, the company is transforming itself into a comprehensive home appliance rental company through product diversification and aggressive marketing. Through overwhelming competitiveness and experience accumulated via years of business engaged in the water purifier market, Coway is demonstrating meaningful achievements in other home appliance businesses. With the firm's flagship product, water purifiers, cementing its dominant position with a 45% share of the corresponding market, other products (e.g., water purifiers, bidets, water softeners) are maintaining market shares of between 40-60% as well, taking the lead in the market.

Domestic bed (mattress) market, valued at KRW1.2tr as of 2015, grew at CAGR of 9% over past decade

According to the Korea Furniture Association, the domestic bed (mattress) market grew to KRW1.2tr in 2014, exceeding KRW1tr in value. This indicates a CAGR of 9% over the past 10 years. We surmise that the mattress market's growth has been driven by: 1) new market entrants and 2) new service launches (rentals included) in addition to existing lump-sum sales. New market players have taken away a big chunk of market shares held by existing big market players (combined market share of Ace Bed and Simmons Bed: 44% in 2005 39% in 2014). Coway's mattress market share also expanded to 5.6% in 2014.

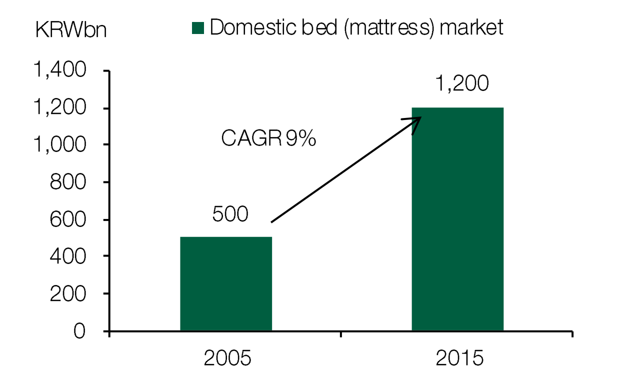
Mattress rentals account for of 42% of total mattress market

Coway and other latecomers have garnered shares in the mattress market via continued customer management and services. In particular, rental service business is leading the mattress market's overall growth based on reasonable prices and hygiene management services. The mattress rental market was scaled at about KRW500bn in 2014, which corresponds to 42% of the total mattress market.

Coway's mattress sales grew at CAGR of 137% to 254,000 units as of 3Q15

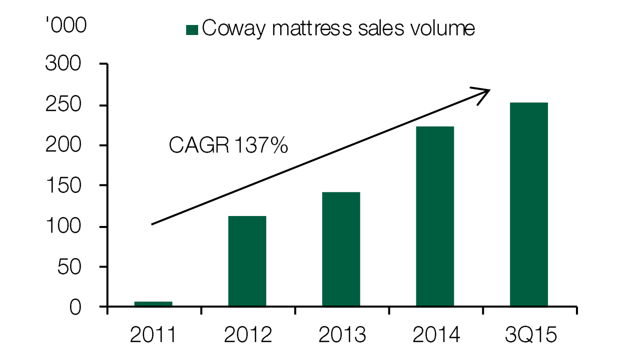
Coway's mattress sales volume grew at a CAGR of 137% from 8,000 units in 2011 to 254,000 units in 3Q15. The domestic mattress market is witnessing intensifying competition amid the influx of new market entrants (e.g., Chungho Nais). However, Coway's mattress rental business (market penetration rate: 90%) looks to sustain stable growth by capitalizing on a replacement cycle and offering steady management services.

Fig 7: Domestic bed (mattress) market scaled at KRW1.2tr



Sources: KFFIC, Hyundai Securities

Fig 8: Coway's mattress sales volume posts CAGR of 137%



Source: Company data, Hyundai Securities

Growth continues, backed by door-to-door sales by Coway ladies (Codi)

16 years of know-how and accumulated experience; 95% of rentals and lump-sum sales are handled via Codis

The company's core competitiveness includes quality products, customer management capabilities and cost management. However, Codis (Coway's sales ladies) have been playing a pivotal role in establishing the company's business foundation and differentiating the company from its peers. 95% of rental and lump-sum sales (sales via market excluded) are handled by Codis. Codi is an abbreviated term for Coway lady, core workforce which has led the company's growth. They visit existing and new clients, taking responsibility for all service areas from product pitches to sales and aftercare. They offer systematic services after receiving the company's own training programs and as their know-how and experience have been accumulated over the past 16 years, their capabilities cannot be easily matched by peers. Codis, which stand at about 13,000 workers, are available anywhere and anytime for consumers to receive necessary services. Basically, they focus on product rental/sales, but they serve as the best marketing means as well, dealing with re-rental, lump-sum sales or even cross-selling of other products by building relationships through continued visits. The penetration rate of water purifiers and bidets stands at 40% in Korea, which is lower than that of Japan (more than 60%), suggesting ample growth potential through Codis.

Overseas Businesses

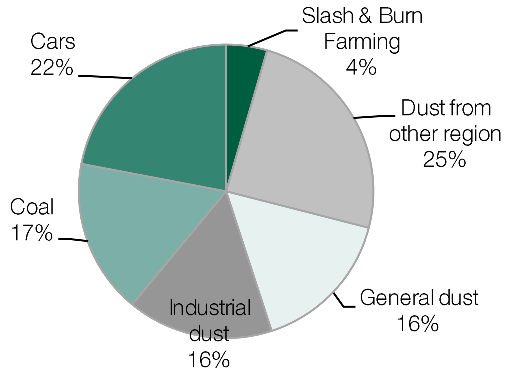
Domestic business revenues account for lion's share of company-wide OR, but Coway to sustain stable growth in overseas markets as well

Domestic business revenues account for more than 85% of Coway's total OR and most of its OP (2014 overseas OP: KRW600mn). However, Coway has continuously invested in overseas markets, and it seems that Coway is just suffering growing pains like many other overseas companies in the Chinese market. Just as Coway established a stable business model in the domestic wellness home appliance market via rental services, the company is forecast to see stable growth in overseas markets as well based on experiences accumulated in the domestic market.

Operations based in US, China, Malaysia, and Thailand; "China Living Goods" subsidiary (cosmetics sales) recently sold

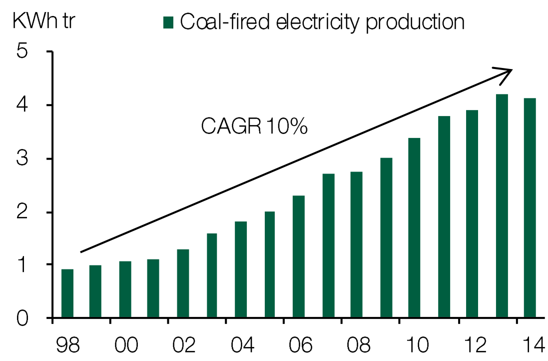
Coway is operating businesses in the US, China, Malaysia, and Thailand. Coway has recently disposed of "China Living Goods", a subsidiary that sold cosmetics and water purifiers in China. As a result, Coway is now operating four overseas subsidiaries, of which Coway holds 100% ownership. Coway is also operating air purifier business based on an ODM (Original design manufacturer) basis in China and the revenues are being reflected as exports. Except for ODM sales, domestic dealer sales are being undertaken by Coway China subsidiary, which is scheduled to launch proprietary brand products ahead. Against this backdrop, Coway's growth potential in China will stand out further.

Fig 9: Causes of smog in Beijing



Source: City of Beijing, Hyundai Securities

Fig 10: China's coal-fired electricity production trend



Source: IEA, Hyundai Securities

Air purifiers and masks can be short-term solutions to smog and fine dust in China

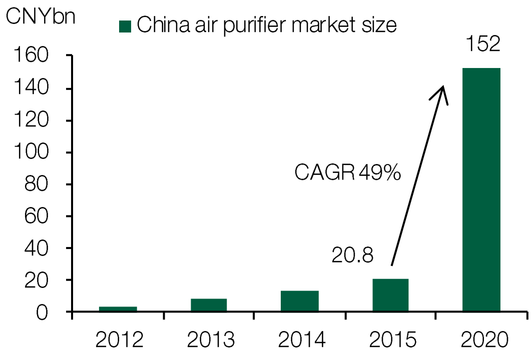
Penetration rate of air purifiers stands only at 1-2% in China

Fundamental solutions to air pollution in China require enormous time and efforts, so short-term solutions can be responses by individuals, such as the use of air purifiers and masks. This is a very positive factor for the company's air purifier business in China and given that the penetration rate of air purifiers in China stands only at 1-2%, the company is deemed to possess ample growth potential. Company "P," which exports Coway's OEM air purifiers, is in the lead in China in terms of brand awareness and market share and unlike other home appliances, air purifiers have a short new product cycle and are diverse in terms of brands (140 new brands launched in 2014, more than 400 brands competing), so if Coway's own brand name products are launched, it would be easier for the company to penetrate into the Chinese market.

Chinese air purifier market likely to grow at CAGR of 4% to CNY152bn (KRW20tr) by 2020

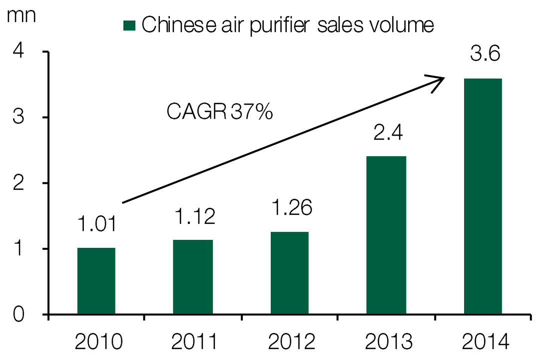
Demand for air purifiers in China is forecast to grow as a necessity rather than as a value-added product. Rather than being used as devices to improve the quality of life, air purifiers in China are required to maintain basic air quality and retain living conditions that existed before air pollution became a life-threatening issue. Chinese consumers are feeling a sense of crisis from worsening air pollution stemming from surging smog and fine dust and therefore, they are reacting by buying air purifiers and masks. The Chinese air purifier market is projected to grow at a CAGR of 4% to CNY152bn (about KRW20.5tr) by 2020.

Fig 11: China's air purifier market size trend



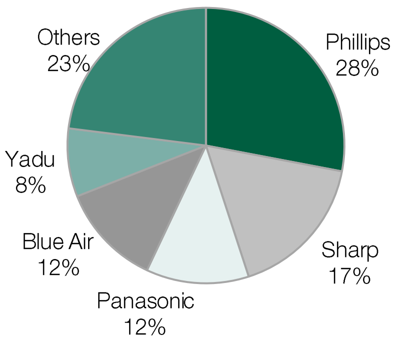
Source: CMM, Hyundai Securities

Fig 12: Chinese air purifier sales volume trend



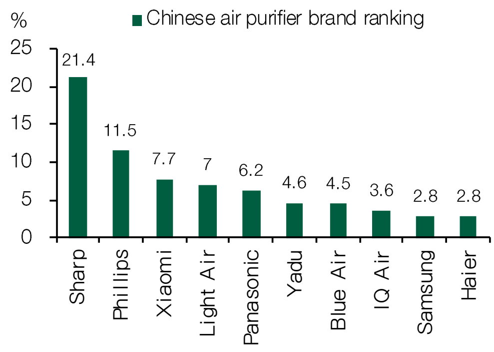
Source: CMM, Hyundai Securities

Fig 13: China's air purifier market share



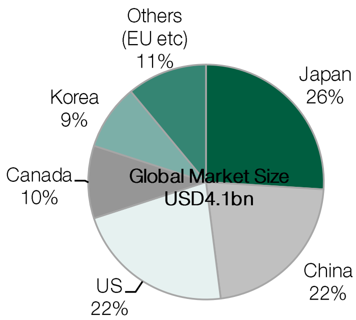
Note: As of 2014
Source: DX Consulting, Hyundai Securities

Fig 14: Chinese air purifier brand ranking



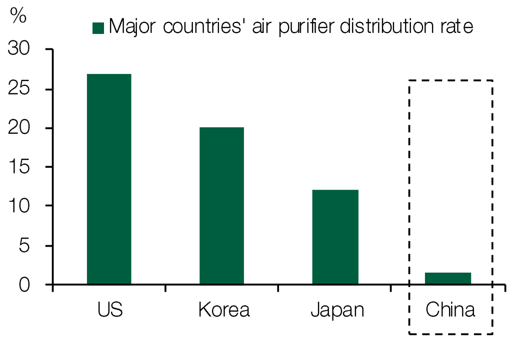
Note: As of Jan 2015
Sources: Chinese Internet Consumer Research Center, Hyundai Securities

Fig 15: Global air purifier market proportion by region



Source: CMM, Hyundai Securities

Fig 16: Distribution rate of air purifiers in major countries



Source: CMM, Hyundai Securities

Penetration rates of water purifiers and bidets in China are just 3-5% and 0.1%, respectively

We believe that Coway's flagship products, water purifiers and bidets, harbor great growth potential in China. Just like air purifiers, the penetration rates of these appliances are very low in China (water purifiers 3-5%, bidets 0.1%). Moreover, Chinese consumers' brand royalty and trust in domestic brands are still low. Hence, the market penetration of Coway's products would be easy compared to other home appliances.

Chinese consumers' interest heightening in water quality and hygiene due to continued environmental pollution

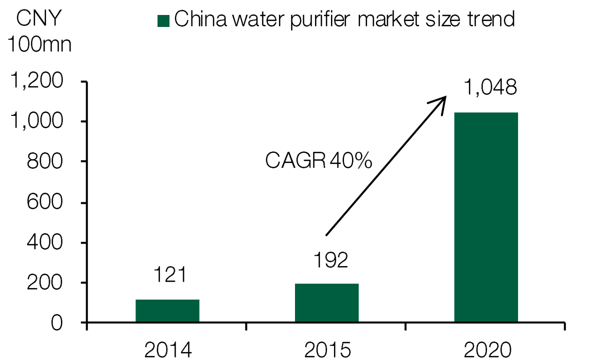
More than 90% of total cities exposed to risky levels of water pollution

The Ministry of Water Resources of the People's Republic of China tested water quality tests of 700 downstream rivers in China. It turned out that 47% of rivers are polluted and 11% seriously polluted. In addition, more than 90% of China's cities face risky levels of water pollution. Such water pollution has an adverse impact not only on industrial and agricultural output, but also on the general public's health. According to the China Household Electrical Appliances Association, more than 50% of residents in tier 1-2 cities suspect water pollution in their cities, which is leading to growth in demand for water purifier. As Chinese consumers recognize the risk of water pollution and their interest in health and hygiene is heightening, the water purifier market is forecast to expand ahead. The penetration rate of water purifiers in China is projected to exceed 20% by 2017, and the market's size to expand from current CNY19.2bn (KRW3.5tr) to CNY105bn (KRW19tr) by 2020.

About 4,000 water purifier brands being sold in China; Uptrend in consumption of premium water purifiers among Chinese consumers

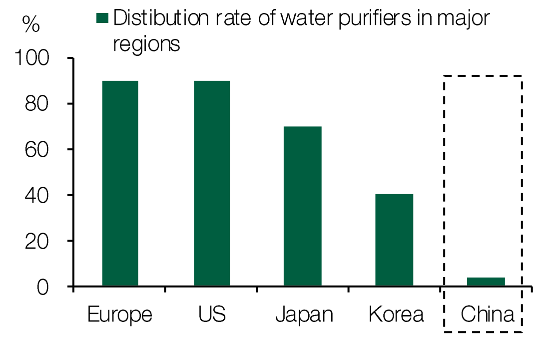
The level of awareness is not that high among Chinese consumers when it comes to wellness home appliances, but domestic companies will be able to secure competitiveness in the China market as Korea's water processing technology is a cut above that of China and domestic companies' capabilities in the making of eco-friendly products and water purifying technology are sufficient. There are about 4,000 water purifier brands in China and Europe and US companies account for a dominant market share in premium lineups, while Chinese local companies command an overwhelming share of low/mid-priced products. However, with no distinct leaders in the water purifier market, the company's effective rental business models and aftercare services will likely lead steady growth. Together with this, with Chinese consumers' consumption of premium water purifiers on the rise, the company's demand for premium products will likely rise in tandem.

Fig 17: China's water purifier market size trend



Source: KOTRA, Hyundai Securities

Fig 18: Global distribution rate of water purifiers in major countries



Source: KOTRA, Hyundai Securities

Earnings Forecast and Other Estimates (Dividends/Risks)

2015 consolidated OR and OP likely to stand at KRW2.27tr (up 5%YoY) and KRW440bn (up 20.8%YoY), respectively

2015 consolidated OR and OP are projected to stand at KRW2.27tr (up 5%YoY) and KRW440bn (up 20.8%YoY, OP margin of 19.4%), respectively. The earnings improvements are largely attributed to a rise in lump-sum sales, which were lackluster in 2014. We surmise that lump-sum sales improved on marketing and strategic changes and the ARPU of Coway's flagship rental service business climbed on the increased sales proportion of high value-added products. Sluggish overseas earnings, especially anemic earnings in China, were disappointing, but overseas earnings seem to have hit bottom in 4Q15.

2016 consolidated OR to reach KRW2.41tr (up 6.4%YoY) and OP KRW462.4bn (up 5.1%YoY)

Coway's 2016 consolidated OR and OP are projected to climb 6.4%YoY to KRW2.41tr and 5.1%YoY to KRW462.4bn (OP margin of 19.2%), respectively. With the rental service market continuously growing, Coway is forecast to sustain top-line growth in 2016 as well. Amid growth in flagship water purifier, air purifier, and bidet sales, the mattress homecare business is also expected to keep growing. As for the overseas business, Coway looks to enjoy earnings contributions from Malaysia and US subsidiaries and see steady growth in China.

Consolidated OR and OP to see CAGRs of 5.3% and 4.8%, respectively, until 2018

The biggest merit of Coway is its business model that generates stable cash flows. Moreover, the company's largest shareholder MBK Partners is expected to manage Coway's profitability until it sells Coway. Accordingly, Coway's OR and OP are projected to see CAGRs of 5.3% and 4.8%, respectively, until 2018. The OP margin is also likely to remain in the early 19% range.

Fig 19: Coway's earnings trend

(KRWbn)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15E	2014	2015F	2016F	2017F
Rental account	4,454,812	4,487,175	4,537,691	4,600,582	4,666,185	4,747,355	4,779,581	4,841,716	4,600,582	4,841,716	5,083,244	5,321,109
Membership account	1,014,264	1,052,055	1,033,789	1,016,086	994,392	967,025	943,791	924,915	1,016,086	924,915	853,112	786,884
Consolidated OR	535.0	556.9	525.5	542.9	548.2	555.3	580.5	583.8	2,160.3	2,267.8	2,413.6	2,535.5
Enviromental appliances OR	419.1	436.5	431.3	438.3	444.6	463.5	486.5	492.7	1,725.2	1,887.3	2,042.7	2,138.4
Rental OR	342.4	346.7	352.7	358.8	363.3	371.2	376.4	386.6	1,400.6	1,497.5	1,598.9	1,697.2
Membership OR	43.9	45.8	46.8	46.9	46.0	45.3	59.3	59.4	183.4	210.0	240.3	246.1
Lump-sum OR	27.6	37.4	31.8	32.6	35.3	47.0	50.8	46.7	129.3	179.8	203.4	195.1
Cosmetics	21.0	22.3	17.2	20.0	23.1	21.1	18.6	20.2	80.5	83.0	83.9	86.4
Exports	45.2	55.7	33.0	33.5	33.0	39.0	35.8	38.8	167.4	146.6	165.8	194.7
ODM/Dealers	34.2	41.6	20.0	24.5	24.8	18.8	15.9	20.8	120.3	80.3	85.8	94.4
Overseas affiliates	11.0	14.1	13.0	9.0	8.2	20.2	19.9	18.0	47.1	66.3	80.0	100.4
Others	49.7	42.4	44.0	51.1	47.5	31.7	39.6	32.1	187.2	150.9	121.2	115.9
COGS	182.3	187.9	168.2	188.2	175.2	170.6	178.1	197.3	726.6	721.2	772.7	813.7
COGS-to-OR ratio	*34.1*	*33.7*	*32.0*	*34.7*	*32.0*	*30.7*	*30.7*	*33.8*	*33.6*	*31.8*	*32.0*	*32.1*
Gross profit	352.7	369.0	357.3	354.7	373.0	384.7	402.4	386.5	1,433.7	1,546.6	1,640.9	1,721.8
Gross profit margin	*65.9*	*66.3*	*68.0*	*65.3*	*68.0*	*69.3*	*69.3*	*66.2*	*66.4*	*68.2*	*68.0*	*67.9*
SG&A	262.4	271.9	262.0	273.0	272.7	274.2	278.4	281.2	1,069.3	1,106.5	1,178.5	1,234.0
SG&A ratio	*49.1*	*48.8*	*49.9*	*50.3*	*49.7*	*49.4*	*48.0*	*48.2*	*49.5*	*48.8*	*48.8*	*48.7*
OP	90.3	97.1	95.3	81.7	100.3	110.5	124.0	105.3	364.4	440.1	462.4	487.9
OP margin (%)	*16.9*	*17.4*	*18.1*	*15.0*	*18.3*	*19.9*	*21.4*	*18.0*	*16.9*	*19.4*	*19.2*	*19.2*
EBT	88.4	86.5	85.9	71.5	101.1	108.9	121.7	101.9	332.4	433.6	455.5	481.1
NP	66.1	66.3	63.9	53.4	77.6	82.7	92.4	77.2	249.7	329.8	346.0	365.3
(%YoY)												
Consolidated OR	5.4	0.1	(0.9)	3.6	2.5	(0.3)	10.5	7.5	2.0	5.0	6.4	5.1
Enviromental appliances OR	3.0	3.3	4.3	6.3	6.1	6.2	12.8	12.4	4.2	9.4	8.2	4.7
Rental OR	3.3	6.1	5.3	5.8	6.1	7.1	6.7	7.7	5.1	6.9	6.8	6.1
Membership OR	13.1	(4.7)	8.4	7.4	4.8	(1.0)	26.6	26.7	5.6	14.5	14.4	2.4
Lump-sum OR	(24.7)	(21.8)	(8.6)	1.6	28.1	25.7	59.7	43.3	(14.5)	39.0	13.1	(4.1)
Cosmetics	17.3	0.9	3.6	1.0	10.0	(5.4)	8.1	1.0	5.4	3.1	1.0	3.1
Exports	43.5	25.2	(13.2)	9.5	(27.0)	(30.0)	8.5	15.9	15.8	(12.4)	13.1	17.5
Membership OR	43.1	7.5	(26.2)	6.5	(27.5)	(54.8)	(20.5)	(15.0)	6.7	(33.2)	6.8	10.0
Overseas affiliates	44.7	143.1	19.3	18.4	(25.5)	43.3	53.1	100.0	47.6	40.8	20.7	25.5
Others	(2.9)	(37.1)	(29.5)	(16.7)	(4.5)	(25.2)	(10.0)	(37.2)	(22.7)	(19.4)	(19.6)	(4.4)
COGS	8.8	(2.5)	(8.7)	6.7	(3.9)	(9.2)	5.9	4.9	0.8	(0.7)	7.1	5.3
Gross profit	3.8	1.5	3.2	2.0	5.7	4.3	12.6	9.0	2.6	7.9	6.1	4.9
SG&A	(2.8)	(3.5)	4.8	6.5	3.9	0.9	6.2	3.0	1.0	3.5	6.5	4.7
OP	29.4	18.6	(1.0)	(10.4)	11.1	13.7	30.1	28.9	7.5	20.8	5.1	5.5
EBT	17.5	6.8	6.9	(20.9)	14.3	25.9	41.6	42.4	1.6	30.4	5.1	5.6
NP	15.2	11.0	6.4	(21.4)	17.4	24.8	44.5	44.7	1.9	32.1	4.9	5.6

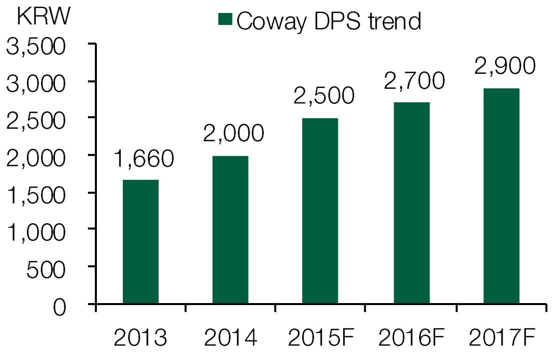
Source: Company data, FnGuide, Hyundai Securities

Operation focused on margins; shareholder-friendly policy kept intact

Dividend yield estimated at 3%-range

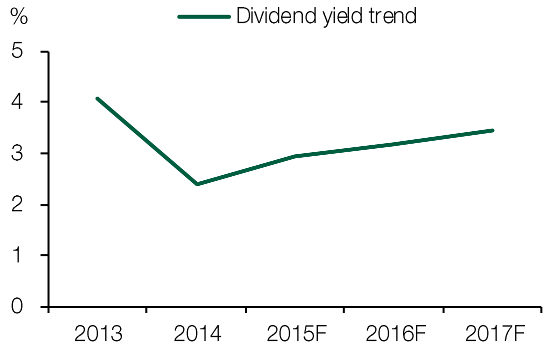
One of the investment merits lies in the company's largest stakeholder MBK Partners (private equity fund)'s eco-friendly policy. Following the acquisition of Woongjin Coway in 2013, the PEF has been operating the company with margins in focus via cost cutbacks, management of the cancellation rate and reduction of losses from rental asset obsolescence in order to enhance enterprise value and has been sticking to a shareholder-friendly policy by offering high dividends. The dividend yield, which was low in 2014, is projected to rise gradually and is estimated to stand at the 3%-range this year.

Fig 20: Coway's DPS trend



Source: KOTRA, Hyundai Securities

Fig 21: Dividend yield expected to recover



Source: KOTRA, Hyundai Securities

Coway's enterprise value soared thanks to margin-focused operation and shareholder-friendly policy following MBK Partners' acquisition of Coway

At a time when the largest domestic PEF, MBK Partners acquired Coway, Coway's enterprise value relative to the acquisition price was estimated to rise, so the acquisition offered upside momentum. In actuality, following the acquisition in 2013, the share price nearly tripled, driven by a rise in the enterprise value stemming from the reduction of unnecessary expenses and strategies to manage profitability and shareholder-friendly policy. Conversely, this may serve as a risk factor for the company and the rise in the enterprise value could lead to re-sale risks.

Re-sale procedures underway on increased enterprise value due to nature of PEF; This may serve as overhang risk

Disposal procedures being delayed due to differences in sale prices; In light of outlook and enterprise value of Coway, enterprise value is unlikely to be degraded even after re-sale

MBK Partners has recently put Coway up for sale on the M&A market, as it believes Coway's enterprise value has reached an appropriate level. MBK Partners proceeded with the bid in end-2015, as promising candidates, including Haier (the largest electronics maker in China), the CJ Group, and the Carlyle Group (private equity fund, PEF), showed interest in the takeover of Coway. However, the bid was halted, as opinions on prices remained divided (MBK Partners asked for more than KRW3tr, but bidders wanted the low-end of KRW2tr). It is uncertain when the bid will be resumed, which could act as a short-term overhang risk factor. However, some speculate that the domestic M&A market will top KRW80tr in 2016. Accordingly, the market is likely to shift towards a buyer's market, which could act as a stumbling block to MBK Partners's efforts to maintain a fair disposal price. Given Coway's enterprise value and outlook, however, MBK Partners is not likely to lower its target selling price. Hence, the disposal of Coway could take longer than expected. Even if MBK Partners succeeds in selling Coway, Coway's enterprise value is not likely to be undermined over the short term. If Coway is acquired by a company other than a PEF, Coway's profitability could deteriorate, but its enterprise value is forecast to ascend, driven by new business-related momentum and continued growth in the domestic rental market and overseas markets.

Domestic rental market's growth could slow down, which, however, would be offset by Coway's firm domestic market standing and overseas momentum

The domestic rental market's growth outlook appears murky, given new market entrants and price war-triggered intensifying competition. However, Coway's domestic market standing is firm, and the slowing growth of the domestic market could be offset by stable growth based on existing rental accounts and overseas growth.

Profit & Loss					
(KRWbn)	12/13A	12/14A	12/15F	12/16F	12/17F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	2,118.3	2,160.3	2,267.7	2,413.6	2,535.5
Cost of sales	721.0	726.6	721.2	772.7	813.7
Gross profit	1,397.4	1,433.7	1,546.5	1,640.9	1,721.8
SG&A expenses	1,058.3	1,069.3	1,106.5	1,178.5	1,234.0
Other operating income	0.0	0.0	0.0	0.0	0.0
Operating profit	339.0	364.4	440.0	462.4	487.9
EBITDA	537.2	578.0	667.6	693.0	718.1
Non-operating accounts	(11.9)	(32.0)	(6.4)	(6.9)	(6.8)
Net financing income	(14.5)	(8.9)	(3.6)	(3.7)	(3.8)
Profit on equity method	17.6	0.0	0.0	0.0	0.0
Net other non-operating income	(15.0)	(23.1)	(2.8)	(3.2)	(3.0)
Profit before tax	327.1	332.4	433.6	455.5	481.1
Income tax expense	82.1	82.8	103.8	109.5	115.7
Net profit	245.1	249.7	329.8	346.0	365.3
Profit attributable to owners of parent	245.1	249.7	329.9	346.0	365.3
Total comprehensive income	243.8	241.1	324.0	346.0	365.3
TCI, attributable to owners of parent	243.8	241.1	324.0	346.0	365.3
Net exceptionals	0.0	0.0	0.0	0.0	0.0
Adj. net profit	245.1	249.7	329.9	346.0	365.3

Cash Flow					
(KRWbn)	12/13A	12/14A	12/15F	12/16F	12/17F
Net profit	245.1	249.7	329.8	346.0	365.3
Depreciation & amortization	198.2	213.6	227.6	230.5	230.2
Other non-cash adjustments	176.0	201.7	179.5	109.5	115.7
Investments in working capital	(41.1)	(29.1)	(76.2)	(0.9)	1.4
Other operating cash flow	(41.5)	(99.1)	(110.7)	(109.7)	(115.6)
Cash flow from operating activities	536.8	536.7	550.0	575.4	597.0
Capital expenditure	(258.3)	(296.2)	(244.7)	(300.0)	(320.0)
Investments in intangibles	(2.4)	(6.0)	(5.0)	(5.0)	(5.0)
Changes in current financial assets	(3.1)	0.2	(0.6)	1.0	0.5
Changes in investment assets	183.0	0.1	3.1	(1.7)	0.9
Other investment cash flow	4.6	2.7	(15.5)	(36.1)	(43.9)
Cash flow from investing activities	(76.3)	(299.2)	(262.7)	(341.8)	(367.5)
Proceeds from (repayments of) debt	(261.6)	(169.1)	(11.6)	(1.5)	(1.5)
Changes in equity	(13.9)	(27.6)	5.2	0.0	0.0
Dividends paid	(78.4)	(123.6)	(148.3)	(185.7)	(200.6)
Other financing cash flow	(19.0)	(7.6)	(12.6)	(0.2)	0.1
Cash flow from financing activities	(372.9)	(327.9)	(167.3)	(187.5)	(201.9)
Other cash flow	(1.3)	(0.9)	(0.5)	0.0	0.0
Increase/decrease in cash	86.3	(91.3)	119.5	46.1	27.5
Cash and cash equivalents at FYB	152.4	238.7	147.4	266.9	313.0
Cash and cash equivalents at FYE	238.7	147.4	266.9	313.0	340.5
	0.0	0.0	0.0	0.0	0.0
Gross operating cash flow	448.0	485.6	561.2	581.6	600.8
Free cash flow	135.3	134.3	164.5	239.5	233.3
Net cash flow	341.7	70.0	127.6	46.6	28.5
Net cash (net debt)	(91.2)	(21.2)	106.4	153.0	181.4

Operating Statistics & Ratios					
(%)	12/13A	12/14A	12/15F	12/16F	12/17F
OR growth	6.3	2.0	5.0	6.4	5.1
OP growth	49.9	7.5	20.7	5.1	5.5
EBITDA growth	31.1	7.6	15.5	3.8	3.6
NP growth of parent	160.7	1.9	32.1	4.9	5.6
Adj. NP growth	160.7	1.9	32.1	4.9	5.6
OP margin	16.0	16.9	19.4	19.2	19.2
EBITDA margin	25.4	26.8	29.4	28.7	28.3
NP margin	11.6	11.6	14.5	14.3	14.4
Adj. NP margin	11.6	11.6	14.5	14.3	14.4

Statement of financial position					
(KRWbn)	12/13A	12/14A	12/15F	12/16F	12/17F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Cash and cash equivalents	238.7	147.4	266.9	313.0	340.5
Current financial assets	6.5	6.4	3.5	2.5	2.0
Trade receivables	212.6	208.8	227.9	227.9	227.9
Inventories	65.8	61.9	65.5	65.5	65.5
Other current assets	167.9	172.4	189.3	189.3	189.3
Current assets	691.4	596.8	753.0	798.2	825.2
Investment assets	81.8	81.4	78.0	79.7	78.9
Property, plant and equipment	638.3	675.2	633.4	710.0	806.7
Intangible assets	176.8	170.6	167.2	165.0	163.2
Deferred tax assets	0.3	0.9	2.4	2.4	2.4
Other non-current assets	79.3	96.7	167.5	203.7	247.5
Non-current assets	976.4	1,024.8	1,048.5	1,160.8	1,298.6
Total assets	1,667.9	1,621.6	1,801.6	1,959.0	2,123.8
Trade payables	36.7	59.0	60.2	60.8	61.4
Short-term financial liabilities	328.0	164.5	148.0	146.5	145.1
Current provisions	4.2	1.4	1.4	1.4	1.4
Other current liabilities	307.8	301.1	304.1	302.6	303.3
Current liabilities	676.7	526.0	513.8	511.4	511.3
Non-current financial liabilities	8.3	10.4	16.0	16.0	16.0
Non-current provisions	0.6	0.7	0.6	0.6	0.6
Provisions for employee benefits	8.4	16.0	16.3	16.1	16.2
Deferred tax liabilities	21.4	20.1	20.5	20.3	20.4
Other non-current liabilities	11.5	9.0	9.2	9.1	9.2
Non-current liabilities	50.2	56.2	62.5	62.1	62.3
Total liabilities	727.0	582.2	576.3	573.5	573.6
Issued capital	40.7	40.7	40.7	40.7	40.7
Share premium	126.2	126.5	126.5	126.5	126.5
Other equity interest	(94.4)	(114.5)	(104.2)	(104.2)	(104.2)
Accumulated other comprehensive income	0.4	(0.0)	(5.4)	(5.4)	(5.4)
Retained earnings	868.0	985.9	1,166.9	1,327.1	1,491.8
Equity attributable to owners of parent	940.9	1,038.5	1,224.4	1,384.7	1,549.4
Non-controlling Interests	0.0	0.9	0.9	0.9	0.8
Total equity	940.9	1,039.4	1,225.3	1,385.5	1,550.2
Total Liab. and equity	1,667.9	1,621.6	1,801.6	1,959.0	2,123.8

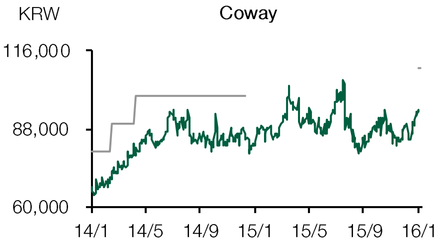
Per-share Performance					
(KRW)	12/13A	12/14A	12/15F	12/16F	12/17F
EPS	3,288	3,360	4,443	4,657	4,917
Adj. EPS	3,288	3,360	4,443	4,657	4,917
BPS	12,635	14,001	16,480	18,637	20,854
SPS	28,421	29,068	30,548	32,485	34,126
GCFPS	6,011	6,534	7,560	7,828	8,086
DPS	2,710	2,000	2,500	2,700	2,900
3yr CAGR of adj. EPS	52.0	12.3	13.5	5.4	5.5

Shareholder Value & Financial Structure					
(%)	12/13A	12/14A	12/15F	12/16F	12/17F
ROE	28.4	25.2	29.2	26.5	24.9
ROA	15.1	15.7	19.5	18.6	18.1
ROIC	25.1	27.3	31.9	31.0	29.5
WACC	7.2	3.9	7.2	7.9	7.9
ROIC/WACC (x)	3.5	7.0	4.4	3.9	3.7
Economic profit (KRWbn)	176.7	233.9	260.5	265.7	276.3
Total liab./equity	77.3	56.0	47.0	41.4	37.0
Net debt/equity	9.7	2.0	Net cash	Net cash	Net cash
Interest coverage (x)	28.9	50.1	125.9	124.3	127.5

Note: Adj. EPS = [(Adjusted NP - preferred share NP) + (after-tax dilution adjustment)] / (diluted avg. number of ordinary shares outstanding), Adjusted NP = (Parent NP) - (net exceptional gains)
Net exceptional gains: After-tax exceptional gains (exceptional gains attributable to parent including FX gains, derivatives gains, valuation gains, one-off gains and discontinued operation gains)
Reporting standard: IFRS-C = Consolidated financial statements, IFRS-I = Individual financial statements, IFRS-S = Separate financial statements
Source: Coway, HyundaiSecurities

Disclosures

■ Rating and Target Price Changes



Company	Date	Rating	Target Price (KRW)
Coway	14/03/04	BUY	90,000
	14/04/28	BUY	100,000
	15/12/03	BUY	110,000

▪ Rating: Sector: Overweight (+10% or more), Neutral (-10 - +10%), Underweight (-10% or more)
Company: Strong BUY (+30% or more), BUY (+10 - +30%), Marketperform (-10 - +10%), Underperform (-10% or more) (Share price —, Target Price —)

▪ Proportion of investment rating (As of December 31, 2015)

BUY	Neutral	Sell
86.4	13.2	0.3

* Based on reports presented with investment ratings over the past one year

▪ All Hyundai Securities Research is available via the following electronic databases: Bloomberg, Thomson Reuters, FactSet. Contact your Hyundai Securities sales representative for access.