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Company Update



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Coway (021240)

Moving quickly past crisis

- Coway yesterday reported that its sales rose 0.5% y-y in 3Q as its operating profit fell 14% y-y, with the latter meeting the consensus, but beating our estimate.
- The results should quell concerns from a nickel scandal that have plagued the firm since 2Q, with its sales set to fully normalize in 4Q.
- Our BUY rating and 12-month target price of KRW135,000 are both unchanged, on expectations of: 1) the firm enjoying growth next year on further normalization of operations; and 2) its China operations taking off.

WHAT'S THE STORY?

3Q review: Coway yesterday reported that its sales edged up 0.5% y-y to KRW583.5b in 3Q, but that its operating profit fell 14% y-y and KRW107b. The latter met consensus forecasts but beat our estimate, which was more conservative on expectations of additional costs related to the firm's nickel-related scandal, thanks to rapid normalization of sales and cancellations. The firm's operations improved through the quarter, in an apparent payoff of aggressive risk management, and while its earnings could normalize further, sales likely already re-attained pre-scandal levels last month.

- Coway's rental service sales fell 3% y-y in 3Q, but they would have been flat if excluding KRW11.3b worth of related fee exemptions, which allowed users of tainted devices to replace them with new ones during a six-month period. The company's new rental sales regained 90% of their normal level after falling to 75% of it in July after the nickel scandal hit, while its rental account numbers rose 1% y-y (but fell 2% q-q) as its ARPU contracted 3% y-y.
- The overseas sales of Coway grew 34% y-y to extend an uptick begun in 4Q15, with it also positive that domestic water and air purifier issues have not spread abroad.
- Coway saw its outright sales drop 7% y-y in a turnaround from sharp growth over 3Q15-2Q16, with door-to-door sales staff focused on the nickel issue instead of marketing. Still, the firm said its operations began normalizing in September, and despite high base, such sales ought to return to growth in 4Q.

(Continued on the next page)

AT A GLANCE

SELL HOLD **BUY**

Target price KRW135,000 (47.2%)

Current price KRW91,700

Market cap	KRW7.0t/USD6.1b
Shares (float)	76,380,513 (65.9%)
52-week high/low	KRW113,000/KRW81,300
Avg daily trading value (60-day)	KRW22.1b/ USD19.4m

ONE-YEAR PERFORMANCE

	1M	6M	12M
Coway (%)	-3.9	-7.0	7.6
Vs Kospi (%pts)	-2.1	-7.6	8.8

KEY CHANGES

(KRW)	New	Old	Diff
Recommend.	BUY	BUY	
Target price	135,000	135,000	0.0%
2016E EPS	3,393	3,020	12.4%
2017E EPS	5,220	5,072	2.9%

SAMSUNG vs THE STREET

No of estimates	13
Target price	116,833
Recommendation	3.9

BUY★★★: 5 / BUY: 4 / HOLD: 3 / SELL: 2 / SELL★★★: 1

SUMMARY OF 3Q RESULTS

(KRWb)	3Q16	Chg		Diff (%)	
		(% y-y)	(% q-q)	Samsung	Consensus
Sales	583.5	0.5	5.1	(3.6)	(3.0)
Operating profit	107.0	(13.7)	804.2	50.5	3.6
Pre-tax profit	90.0	(26.0)	1,620.6	29.8	(14.0)
Net profit	67.8	(26.6)	2,344.8	29.6	(13.4)
Margins (%)					
Operating profit	18.3				
Pre-tax profit	15.4				
Net profit	11.6				

Source: Company data, Samsung Securities estimates

VALUATION SUMMARY

	2015	2016E	2017E
Multiples (x)			
P/E	20.4	27.0	17.6
P/B	5.9	5.7	4.9
EV/EBITDA	10.2	12.0	8.8
Div yield (%)	3.1	3.1	3.5
EPS growth (% y-y)	39.3	(24.5)	53.8
ROE (%)	30.1	20.1	29.0
Per-share data (KRW)			
EPS	4,492	3,393	5,220
BVPS	15,465	16,046	18,532
DPS	2,800	2,800	3,200

Still a BUY with KRW135,000 target: As per our expectations, Coway's aggressiveness to compensate consumers had helped its operations rapidly normalize. We therefore only fine-tune our 2017 EPS estimate and maintain our 12-month target price of KRW135,000, which equates to 27x 2016 P/E and is based on a DCF valuation that assumes a WACC of 5.9% and terminal growth of 0.5%. Our BUY rating is also unchanged on expectations of earnings growth and stability, despite macro-economic uncertainties.

Results and forecasts

	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16E	2015P	2016E	2017E	2018E
Earnings summary												
(KRWb)												
Sales	548.2	555.3	580.4	631.3	623.7	555.0	583.5	643.5	2,315.2	2,405.7	2,648.8	2,858.2
Gross profit	373.0	384.7	402.3	426.4	416.6	355.9	391.0	426.6	1,586.4	1,590.2	1,814.4	1,957.9
Operating profit	100.3	110.5	123.9	128.6	123.6	11.8	107.0	110.5	463.3	352.9	541.0	586.9
Pre-tax profit	101.1	108.9	121.7	122.7	125.3	5.2	90.0	116.6	454.5	337.1	533.0	580.1
Net profit	77.6	82.7	92.4	90.5	95.2	2.8	67.7	87.2	343.1	252.8	399.7	435.0
Margins (%)												
Gross profit	68.0	69.3	69.3	67.5	66.8	64.1	67.0	66.3	68.5	66.1	68.5	68.5
Operating profit	18.3	19.9	21.4	20.4	19.8	2.1	18.3	17.2	20.0	14.7	20.4	20.5
Pre-tax profit	18.4	19.6	21.0	19.4	20.1	0.9	15.4	18.1	19.6	14.0	20.1	20.3
Net profit	14.1	14.9	15.9	14.3	15.3	0.5	11.6	13.5	14.8	10.5	15.1	15.2
Chg (% y-y)												
Sales	2.5	(0.3)	10.4	16.3	13.8	(0.1)	0.5	1.9	7.2	3.9	10.1	7.9
Gross profit	5.8	4.3	12.6	20.2	11.7	(7.5)	(2.8)	0.1	10.6	0.2	14.1	7.9
Operating profit	11.1	13.7	30.1	57.4	23.2	(89.3)	(13.7)	(14.1)	27.1	(23.8)	53.3	8.5
Pre-tax profit	14.3	25.9	41.6	71.5	23.9	(95.2)	(26.0)	(5.0)	36.7	(25.8)	58.1	8.8
Net profit	17.4	24.8	44.5	69.6	22.7	(96.6)	(26.7)	(3.7)	37.4	(26.3)	58.1	8.8
Chg (% q-q)												
Sales	1.0	1.3	4.5	8.8	(1.2)	(11.0)	5.1	10.3				
Gross profit	5.2	3.1	4.6	6.0	(2.3)	(14.6)	9.9	9.1				
Operating profit	22.8	10.1	12.2	3.8	(3.9)	(90.4)	804.2	3.3				
Pre-tax profit	41.3	7.8	11.7	0.8	2.1	(95.8)	1,620.4	29.5				
Net profit	45.4	6.6	11.7	(2.0)	5.2	(97.1)	2,339.7	28.8				
Sales breakdown												
Household electronics	439.3	457.9	481.3	504.3	495.0	441.4	478.7	510.3	1,882.9	1,925.3	2,091.4	2,212.1
Outright sales	30.0	41.4	45.6	54.2	50.5	54.1	42.6	54.9	171.2	202.1	226.3	252.0
Rental	363.3	371.2	376.4	380.2	380.1	316.2	367.0	386.7	1,491.1	1,450.0	1,560.6	1,628.5
Membership	46.0	45.4	44.5	43.7	42.9	42.5	42.1	41.4	179.6	168.9	168.9	168.9
Financial lease			14.8	26.1	21.5	28.6	27.0	27.3	40.9	104.3	135.6	162.8
Exports	33.0	39.0	35.8	41.4	56.7	59.8	48.1	51.8	149.3	216.5	270.6	324.7
Cosmetics	23.1	21.1	18.6	20.2	20.1	17.3	18.1	19.2	83.1	74.8	82.2	90.5
Other (water treatment)	10.6	9.4	10.0	16.1	5.8	4.5	5.6	7.1	46.1	23.0	23.0	23.0
Consolidated other	42.1	27.9	34.7	49.3	46.1	32.1	33.0	55.0	194.9	166.1	181.5	207.9
Chg (% y-y)												
Household electronics	6.2	6.5	11.6	16.6	12.7	(3.6)	(0.5)	1.2	10.3	2.3	8.6	5.8
Outright sales	8.8	10.7	43.5	102.9	68.2	30.6	(6.6)	1.3	38.6	18.0	12.0	11.4
Rental	6.1	7.0	6.7	6.0	4.6	(14.8)	(2.5)	1.7	6.5	(2.8)	7.6	4.3
Membership	4.9	(0.8)	(5.0)	(6.7)	(6.8)	(6.4)	(5.4)	(5.4)	(2.0)	(6.0)	0.0	0.0
Financial lease							81.9	4.5			30.0	20.0
Exports	(27.0)	(30.0)	8.5	23.9	71.8	53.3	34.4	25.0	(10.8)	45.0	25.0	20.0
Cosmetics	10.5	(5.3)	8.3	1.1	(13.1)	(17.9)	(2.5)	(5.1)	3.3	(10.0)	10.0	10.0
Other (water treatment)	(28.2)	(38.6)	(31.7)	18.1	(45.3)	(52.1)	(43.4)	(56.0)	(21.0)	(50.0)	0.0	0.0
Consolidated other	4.7	(17.1)	17.7	13.6	9.4	15.1	(4.9)	11.7	32.9	(14.7)	9.3	14.5
Portion of total sales (%)												
Household electronics	80.1	82.5	82.9	79.9	79.4	79.5	82.0	79.3	79.9	80.0	79.0	77.4
Outright sales	5.5	7.5	7.9	8.6	8.1	9.7	7.3	8.5	7.3	8.4	8.5	8.8
Rental	66.3	66.8	64.9	60.2	60.9	57.0	62.9	60.1	63.3	60.3	58.9	57.0
Membership	8.4	8.2	7.7	6.9	6.9	7.7	7.2	6.4	7.6	7.0	6.4	5.9
Financial lease			2.6	4.1	3.4	5.2	4.6	4.2	1.7	4.3	5.1	5.7
Exports	6.0	7.0	6.2	6.6	9.1	10.8	8.2	8.1	6.3	9.0	10.2	11.4
Cosmetics	4.2	3.8	3.2	3.2	3.2	3.1	3.1	3.0	3.5	3.1	3.1	3.2
Other (water treatment)	1.9	1.7	1.7	2.5	0.9	0.8	1.0	1.1	2.0	1.0	0.9	0.8
Consolidated other	7.7	5.0	6.0	7.8	7.4	5.8	5.7	8.6	8.3	6.9	6.9	7.3

Source: Company data, Samsung Securities estimates

Accounts overview

('000)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16
Number of accounts											
Total	5,469	5,539	5,571	5,617	5,661	5,714	5,730	5,771	5,794	5,846	5,732
Chg (% y-y)	3.5	3.2	2.8	2.8	3.5	3.2	2.8	2.8	2.4	2.3	0.0
Rental account	4,455	4,487	4,538	4,601	4,666	4,747	4,780	4,832	4,861	4,921	4,823
Chg (% y-y)	(2.0)	(8.1)	(8.1)	(7.6)	4.7	5.8	5.3	5.0	4.2	3.7	0.9
Membership	1,014	1,052	1,034	1,016	994	967	950	939	933	924	908
Chg (% y-y)	7.5	(0.1)	8.7	8.4	(2.0)	(8.1)	(8.1)	(7.6)	(6.2)	(4.4)	(4.5)
Rental cancellations	129	139	130	130	134	143	151	138	146	148	224
Monthly churn (%)	0.1	1.3	21.5	95.9	3.2	2.7	16.2	6.9	9.1	4.0	47.8
Rental account additions	317	371	311	332	341	371	338	359	351	385	285
Chg (% y-y)	1.0	1.0	1.1	1.0	7.5	(0.1)	8.7	8.4	2.9	3.7	(15.6)
Outright sales account additions	40	60	52	32	40	60	63	63	66	68	54
Chg (% y-y)	4.7	5.8	5.3	5.0	0.1	1.3	21.5	95.9	67.2	12.2	(14.8)

Source:  KRI

Full-year forecast revisions

(KRWb)	2015	New		Old		Chg (%)	
		2016E	2017E	2016E	2017E	2016E	2017E
Sales	2,315	2,406	2,649	2,421	2,609	(0.6)	1.5
Operating profit	463	353	541	319	530	10.7	2.1
Pre-tax profit	454	337	533	311	522	8.6	2.2
Net profit	343	253	400	233	391	8.6	2.2
EBITDA	691	588	798	554	787	6.2	1.4
EPS (KRW)	4,492	3,393	5,220	3,057	5,110	11.0	2.2

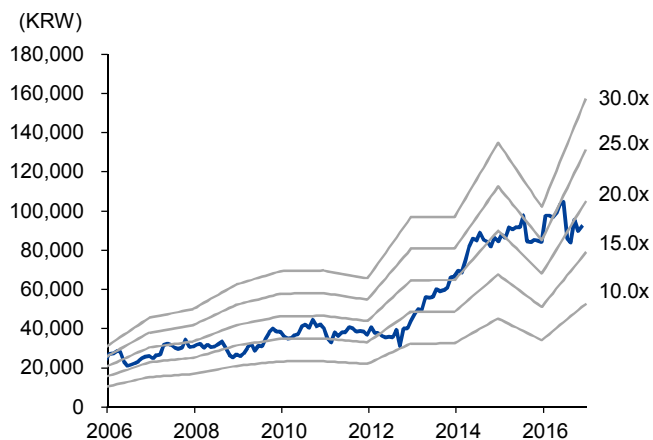
Source: Company data, Samsung Securities estimates

Valuation summary

Year-end	Sales	Op prof	Pre-tax prof	Net prof	EPS	Chg	P/E	P/B	ROE	EV/EBITDA	Net debt
Dec 31	(KRWb)	(KRWb)	(KRWb)	(KRWb)	(KRW)	(% y-y)	(x)	(x)	(%)	(x)	(KRWb)
2013	2,118	339	327	245	3,222	47.5	28.5	8.2	28.4	13.2	83
2014	2,160	364	332	250	3,225	0.1	28.4	7.1	25.2	12.2	12
2015	2,315	463	454	343	4,492	39.3	20.4	5.9	30.1	10.2	(38)
2016E	2,406	353	337	253	3,393	(24.5)	27.0	5.7	20.1	12.0	1
2017E	2,649	541	533	400	5,220	53.8	17.6	4.9	29.0	8.8	(90)
2018E	2,858	587	580	435	5,678	8.8	16.1	4.3	27.7	7.9	(217)

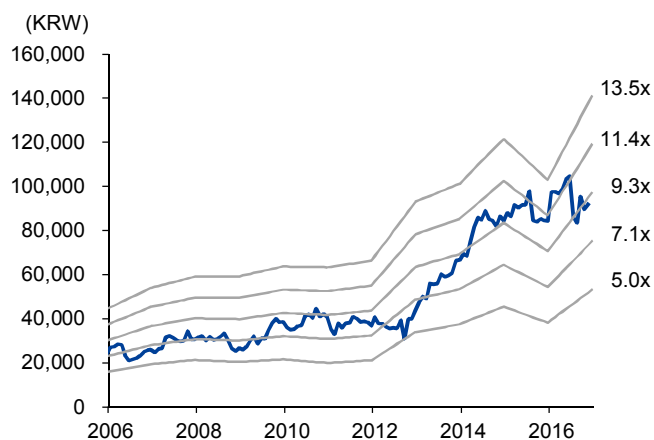
Source: Company data, Samsung Securities estimates

Forward P/E



Source: Company data, Samsung Securities estimates

Forward EV/EBITDA



Source: Company data, Samsung Securities estimates

DCF valuation

(KRWb)	2015	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
EBIT	463	353	541	587	640	702	738	774	813	854	897
Tax	114	102	180	197	204	231	243	255	268	281	295
Capex	329	342	356	356	356	356	360	363	367	371	374
Change in working capital	54	-4	24	19	21	24	25	25	25	25	26
Depreciation	220	227	249	275	304	315	318	322	325	328	331
Amortization	8	8	8	8	8	8	8	8	8	8	8
Free cash flow	195	147	237	297	370	413	436	461	486	513	541
Terminal value	11,690										
Terminal growth (%)	1.0%										
NPV of FCF	2,777										
Present value of terminal value	6,733										
Enterprise value	9,510										
Equity value (adjusted)**	10,370										
Shares outstanding	77,125										
Fair value per share (KRW)	134,463										
Current share price (KRW)*	91,700										
Upside (%)	46.6%										

Note: * As of Nov 1 close; ** reflects a one-month adjustment to end-2016 discount rate

Source: Company data, Samsung Securities estimates

Income statement

Year-end Dec 31 (KRWb)	2014	2015	2016E	2017E	2018E
Sales	2,160	2,315	2,406	2,649	2,858
Cost of goods sold	727	729	816	834	900
Gross profit	1,434	1,586	1,590	1,814	1,958
Gross margin (%)	66.4	68.5	66.1	68.5	68.5
SG&A expenses	1,069	1,123	1,237	1,273	1,371
Operating profit	364	463	353	541	587
Operating margin (%)	16.9	20.0	14.7	20.4	20.5
Non-operating gains (losses)	(32)	(9)	(16)	(8)	(7)
Financial profit	3	1	1	2	3
Financial costs	12	4	4	4	4
Equity-method gains (losses)	0	0	0	0	0
Other	(23)	(6)	(13)	(5)	(5)
Pre-tax profit	332	454	337	533	580
Taxes	83	111	84	133	145
Effective tax rate (%)	24.9	24.5	25.0	25.0	25.0
Profit from continuing operations	250	343	253	400	435
Profit from discontinued operations	0	0	0	0	0
Net profit	250	343	253	400	435
Net margin (%)	11.6	14.8	10.5	15.1	15.2
Net profit (controlling interests)	250	343	253	400	435
Net profit (non-controlling interests)	(0)	(0)	(0)	(0)	(0)
EBITDA	578	691	588	798	870
EBITDA margin (%)	26.8	29.8	24.4	30.1	30.4
EPS (parent-based) (KRW)	3,237	4,449	3,278	5,183	5,641
EPS (consolidated) (KRW)	3,237	4,449	3,278	5,183	5,641
Adjusted EPS (KRW)*	3,237	4,449	3,393	5,220	5,678

Cash flow statement

Year-end Dec 31 (KRWb)	2014	2015	2016E	2017E	2018E
Cash flow from operations	537	513	512	655	722
Net profit	250	343	253	400	435
Non-cash profit and expenses	415	448	235	257	283
Depreciation	206	220	227	249	275
Amortization	8	8	8	8	8
Other	202	221	0	0	0
Changes in A/L from operating activities	(29)	(195)	25	(2)	4
Cash flow from investments	(299)	(329)	(342)	(356)	(356)
Change in tangible assets	(296)	(320)	(342)	(356)	(356)
Change in financial assets	0	(2)	0	0	0
Other	(3)	(7)	0	0	0
Cash flow from financing	(328)	(213)	(170)	(208)	(245)
Change in debt	(176)	(77)	38	(0)	(8)
Change in equity	0	1	0	0	0
Dividends	(124)	(148)	(208)	(208)	(238)
Other	(28)	11	(0)	(0)	(0)
Change in cash	(91)	(31)	0	90	120
Cash at beginning of year	239	147	116	116	206
Cash at end of year	147	116	116	206	326
Gross cash flow	665	792	524	685	748
Free cash flow	231	184	170	298	365

Note: * Excluding one-off items; ** fully diluted, excluding one-off items

*** From companies subject to equity-method valuation

Source: Company data, Samsung Securities estimates

Balance sheet

Year-end Dec 31 (KRWb)	2014	2015	2016E	2017E	2018E
Current assets	597	653	653	774	918
Cash & equivalents	147	116	116	206	326
Accounts receivable	209	256	294	324	350
Inventories	62	70	73	80	86
Other current assets	179	211	170	163	156
Fixed assets	1,025	1,122	1,207	1,284	1,335
Investment assets	55	54	78	78	78
Tangible assets	675	700	785	862	913
Intangible assets	171	169	169	169	169
Other long-term assets	124	199	176	176	176
Total assets	1,622	1,775	1,861	2,058	2,253
Current liabilities	526	473	513	519	517
Accounts payable	59	60	62	68	74
Short-term debt	164	80	118	118	110
Other current liabilities	303	333	333	333	333
Long-term liabilities	56	64	64	64	64
Bonds & long-term debt	1	8	8	8	8
Other long-term liabilities	55	56	56	56	56
Total liabilities	582	537	578	584	581
Owners of parent equity	1,039	1,237	1,282	1,474	1,671
Capital stock	41	41	41	41	41
Capital surplus	126	127	127	127	127
Retained earnings	986	1,177	1,222	1,414	1,611
Other	(114)	(108)	(108)	(108)	(108)
Non-controlling interests' equity	1	1	1	1	1
Total equity	1,039	1,238	1,283	1,475	1,672
Net debt	13	(36)	1	(90)	(217)

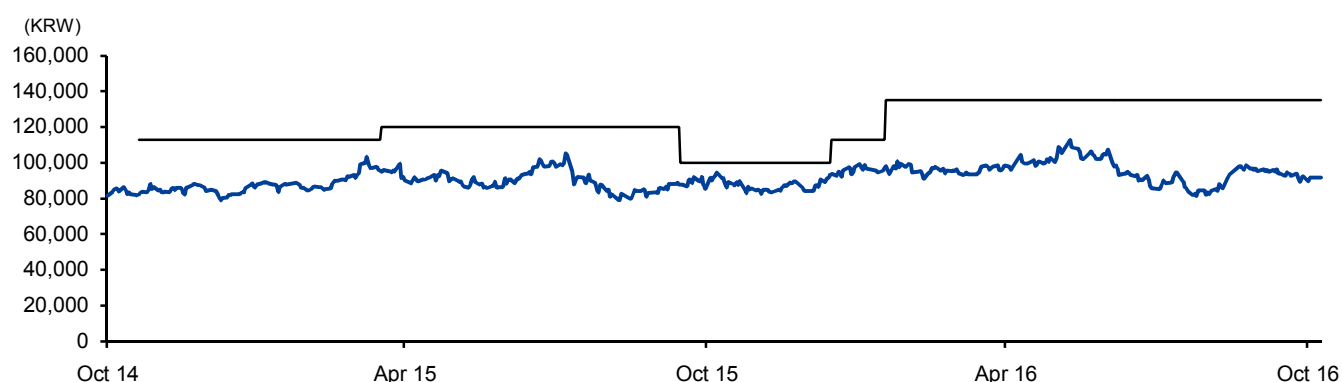
Financial ratios

Year-end Dec 31	2014	2015	2016E	2017E	2018E
Growth (%)					
Sales	2.0	7.2	3.9	10.1	7.9
Operating profit	7.5	27.1	(23.8)	53.3	8.5
Net profit	1.9	37.4	(26.3)	58.1	8.8
Adjusted EPS**	1.9	37.4	(23.7)	53.8	8.8
Per-share data (KRW)					
EPS (parent-based)	3,237	4,449	3,278	5,183	5,641
EPS (consolidated)	3,237	4,449	3,278	5,183	5,641
Adjusted EPS**	3,237	4,449	3,393	5,220	5,678
BVPS	14,001	16,654	17,257	19,837	22,493
DPS (common)	2,000	2,800	2,800	3,200	3,500
Valuations (x)					
P/E***	28.3	20.6	27.0	17.6	16.1
P/B***	6.5	5.5	5.3	4.6	4.1
EV/EBITDA	12.1	10.1	11.9	8.7	7.8
Ratios (%)					
ROE	25.2	30.2	20.1	29.0	27.7
ROA	15.2	20.2	13.9	20.4	20.2
ROIC	27.0	31.7	23.4	35.7	36.0
Payout ratio	59.4	60.6	82.3	59.5	59.8
Dividend yield (common)	2.2	3.1	3.1	3.5	3.8
Net debt to equity	1.3	(2.9)	0.0	(6.1)	(13.0)
Interest coverage (x)	31.6	106.8	96.2	125.4	140.5

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- As of Nov 1, 2016, the covering analyst(s) did not own any shares, or debt instruments convertible into shares, of any company covered in this report.
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Target price changes in past two years



Rating changes in past two years

Date	2014/11/19	2015/4/16	10/15	2016/1/15	2/17
Recommendation	BUY	BUY	BUY	BUY	BUY
Target price (KRW)	113,000	120,000	100,000	113,000	135,000

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Company

BUY★★★	Expected to increase in value by 30% or more within 12 months and is highly attractive within sector
BUY	Expected to increase in value by 10% or more within 12 months
HOLD	Expected to increase/decrease in value by less than 10% within 12 months
SELL	Expected to decrease in value by 10% or more within 12 months
SELL★★★	Expected to decrease in value by 30% or more within 12 months

Industry

OVERWEIGHT	Expected to outperform market by 5% or more within 12 months
NEUTRAL	Expected to outperform/underperform market by less than 5% within 12 months
UNDERWEIGHT	Expected to underperform market by 5% or more within 12 months

Percentage of ratings in 12 months prior to Jun 30, 2016

BUY (71.2%) | HOLD (28.8%) | SELL (0%)

Global Disclosures & Disclaimers

General

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