



# Coway (021240)

**BUY (maintain)**

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## 3Q16 Earnings Review

Current price (Nov 1)	KRW91,700
Target Price	KRW100,000

- OP down 13.7%YoY, poor 3Q16 earnings due to ice-making water purifier scandal
- Sluggish 3Q16 earnings already anticipated, key is normalization of future earnings
- Stabilizing monthly rental accounts and cancellation rate are positive, Recovery of water purifier business needs to be checked
- Maintain BUY with target price of KRW100,000

**Fig 1: Poor earnings due to drop in accounts from nickel scandal**

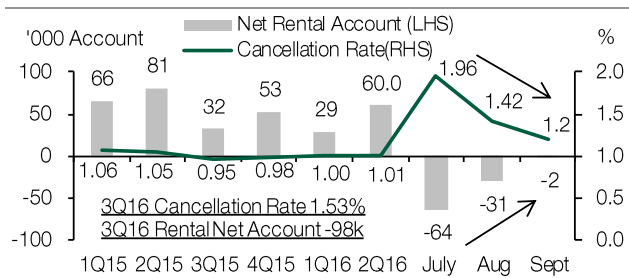
(KRWbn)	3Q16P	Growth(%)		HRC Est.	Market Cons.
		YoY	QoQ		
OR	583.5	0.5	5.1	610.1	606.4
OP	107.0	(13.7)	804.2	114.9	107.9
EBT	90.0	(26.0)	1,620.4	112.5	106.0
NP	67.7	(26.7)	2,339.7	84.7	77.8

Source: Company data, Hyundai Securities

### Poor 3Q16 earnings as anticipated due to nickel scandal

Coway achieved poor 3Q16 earnings with OR rising only 0.5%YoY, while OP declined 13.7%YoY. Poor 3Q16 earnings were anticipated and were due to a drop in rental accounts (cancellation rate of 1.01% in 2Q16 -> 1.53% in 3Q16, net rental accounts down by 98,000) due to the nickel scandal. In addition KRW11.3bn worth of exemptions in rental fees for customers with water purifiers affected by nickel were reflected. The YoY growth in OR was due to other rental sales (up 4.5%YoY) and growth of exports (up 34%YoY). NP was affected by currency fluctuations resulting in a foreign currency translation loss of KRW11.7bn (KRW8.9bn after tax).

**Fig 2: Cancellation rate and net rental accounts improving**

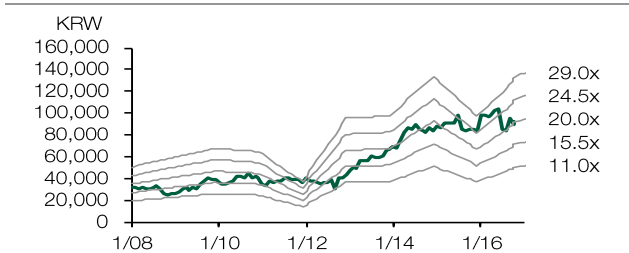


Source: Company data, Hyundai Securities

### Passed trough, 4Q16 is key

The worst has passed. 3Q16 cancellation rate and net rental accounts were extremely weak, but have been improving every month. (Cancellation rate of 1.96% in Jul -> 1.2% in Sep; net rental account down 64,000 in Jul -> down 2,000 in Sep). However the improvements are from an increase in rentals of other products excluding water purifiers, which shows that it is too early to determine if water purifier rental cancellation and net account have normalized. On the other hand conditions are not expected to grow worse and the company's earnings are expected to recover quickly when water purifier operations normalize, since s profitability is recovering due to cost control.

**Fig 3: Current share price at PER of 19.6x level (based on 2017)**



Source: Company data, Hyundai Securities

### Maintain BUY with target price of KRW100,000

We maintain BUY with a target price of KRW100,000. The target price is equivalent to a PER of 21x to the 2017 EPS standard. The current price is within the boxed range as uncertainties over earnings still exist. Although the worst has passed, confidence needs to be affirmed over whether the water purifier business will be able to recover. Long-term risks remain concerning stake sales by majority shareholders and the acquisition of a rival Tongyang Magic by SK Networks. However, we recommend approaching the stock from a trading perspective, considering the company's shareholder-friendly policy at year-end.

For explanations of equity research ratings and disclosures, please refer to the compliance section at the end of this report.

Profit & Loss					
(KRWbn)	12/14A	12/15A	12/16F	12/17F	12/18F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
<b>Operating revenue</b>	<b>2,160.3</b>	<b>2,315.2</b>	<b>2,373.3</b>	<b>2,601.7</b>	<b>2,822.7</b>
Cost of sales	726.6	728.8	799.9	858.5	930.9
<b>Gross profit</b>	<b>1,433.7</b>	<b>1,586.4</b>	<b>1,573.4</b>	<b>1,743.2</b>	<b>1,891.8</b>
SG&A expenses	1,069.3	1,123.1	1,211.2	1,230.8	1,333.2
Other operating income	0.0	0.0	0.0	0.0	0.0
<b>Operating profit</b>	<b>364.4</b>	<b>463.3</b>	<b>362.2</b>	<b>512.4</b>	<b>558.6</b>
<b>EBITDA</b>	<b>578.0</b>	<b>691.0</b>	<b>595.3</b>	<b>745.6</b>	<b>791.5</b>
Non-operating accounts	(32.0)	(8.9)	(26.7)	(7.8)	(7.4)
Net financing income	(8.9)	(2.9)	(3.6)	(4.1)	(4.5)
Profit on equity method	0.0	0.0	0.0	0.0	0.0
Net other non-operating income	(23.1)	(6.0)	(23.1)	(3.7)	(2.9)
<b>Profit before tax</b>	<b>332.4</b>	<b>454.5</b>	<b>335.5</b>	<b>504.6</b>	<b>551.2</b>
Income tax expense	82.8	111.3	89.9	159.6	173.6
<b>Net profit</b>	<b>249.7</b>	<b>343.1</b>	<b>245.6</b>	<b>345.0</b>	<b>377.6</b>
<b>Profit attributable to owners of parent</b>	<b>249.7</b>	<b>343.1</b>	<b>246.7</b>	<b>347.5</b>	<b>380.4</b>
<b>Total comprehensive income</b>	<b>241.1</b>	<b>334.3</b>	<b>240.0</b>	<b>345.0</b>	<b>377.6</b>
<b>TCI, attributable to owners of parent</b>	<b>241.1</b>	<b>334.3</b>	<b>241.1</b>	<b>347.5</b>	<b>380.4</b>
Net exceptionals	0.0	0.0	0.0	0.0	0.0
<b>Adj. net profit</b>	<b>249.7</b>	<b>343.1</b>	<b>246.7</b>	<b>347.5</b>	<b>380.4</b>

Cash Flow					
(KRWbn)	12/14A	12/15A	12/16F	12/17F	12/18F
Net profit	249.7	343.1	245.6	345.0	377.6
Depreciation & amortization	213.6	227.7	233.1	233.2	232.9
Other non-cash adjustments	201.7	220.8	204.0	159.6	173.6
Investments in working capital	(29.1)	(195.3)	(156.7)	(19.1)	(16.0)
Other operating cash flow	(93.1)	(83.4)	(107.0)	(158.9)	(173.6)
<b>Cash flow from operating activities</b>	<b>536.7</b>	<b>512.8</b>	<b>419.0</b>	<b>559.9</b>	<b>594.5</b>
Capital expenditure	(296.2)	(320.4)	(174.3)	(1.3)	(1.4)
Investments in intangibles	(6.0)	(5.4)	(16.1)	(5.0)	0.0
Changes in current financial assets	0.2	0.0	5.2	(1.3)	(1.4)
Changes in investment assets	0.1	3.3	(4.8)	(1.6)	(1.6)
Other investment cash flow	2.7	(7.0)	(23.8)	(56.7)	0.0
<b>Cash flow from investing activities</b>	<b>(299.2)</b>	<b>(329.5)</b>	<b>(213.9)</b>	<b>(65.8)</b>	<b>(4.5)</b>
Proceeds from (repayments of) debt	(169.1)	(77.3)	(0.8)	8.6	7.2
Changes in equity	(27.6)	5.2	4.7	0.0	0.0
Dividends paid	(123.6)	(148.3)	(208.0)	(222.9)	(237.8)
Other financing cash flow	(7.6)	7.0	(22.9)	(0.8)	0.4
<b>Cash flow from financing activities</b>	<b>(327.9)</b>	<b>(213.4)</b>	<b>(227.0)</b>	<b>(215.1)</b>	<b>(230.1)</b>
Other cash flow	(0.9)	(1.0)	(0.3)	0.0	0.0
<b>Increase/decrease in cash</b>	<b>(91.3)</b>	<b>(31.1)</b>	<b>(22.1)</b>	<b>279.0</b>	<b>360.0</b>
Cash and cash equivalents at FYB	238.7	147.4	116.3	94.2	373.1
Cash and cash equivalents at FYE	147.4	116.3	94.2	373.1	733.1
	0.0	0.0	0.0	0.0	0.0
<b>Gross operating cash flow</b>	<b>485.6</b>	<b>580.6</b>	<b>486.1</b>	<b>584.8</b>	<b>616.1</b>
<b>Free cash flow</b>	<b>142.5</b>	<b>(17.4)</b>	<b>51.2</b>	<b>502.9</b>	<b>598.7</b>
<b>Net cash flow</b>	<b>78.2</b>	<b>49.2</b>	<b>(14.9)</b>	<b>271.6</b>	<b>354.2</b>
<b>Net cash (net debt)</b>	<b>(13.0)</b>	<b>36.3</b>	<b>21.3</b>	<b>292.9</b>	<b>647.1</b>

Operating Statistics & Ratios					
(%)	12/14A	12/15A	12/16F	12/17F	12/18F
OR growth	2.0	7.2	2.5	9.6	8.5
OP growth	7.5	27.1	(21.8)	41.5	9.0
EBITDA growth	7.6	19.6	(13.8)	25.2	6.2
NP growth of parent	1.9	37.4	(28.1)	40.9	9.5
Adj. NP growth	1.9	37.4	(28.1)	40.9	9.5
OP margin	16.9	20.0	15.3	19.7	19.8
EBITDA margin	26.8	29.8	25.1	28.7	28.0
NP margin	11.6	14.8	10.3	13.3	13.4
Adj. NP margin	11.6	14.8	10.4	13.4	13.5

Statement of financial position					
(KRWbn)	12/14A	12/15A	12/16F	12/17F	12/18F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Cash and cash equivalents	147.4	116.3	94.2	373.1	733.1
Current financial assets	6.4	9.2	15.7	16.9	18.3
Trade receivables	208.8	256.0	247.8	275.4	298.6
Inventories	61.9	69.8	82.4	91.5	99.2
<b>Other current assets</b>	<b>172.4</b>	<b>202.0</b>	<b>241.6</b>	<b>268.5</b>	<b>291.1</b>
Current assets	596.8	653.3	681.5	1,025.5	1,440.3
Investment assets	81.4	77.7	79.2	80.8	82.4
Property, plant and equipment	675.2	699.5	598.1	373.8	149.6
Intangible assets	170.6	168.8	187.6	185.0	177.7
Deferred tax assets	0.9	0.9	12.2	12.2	12.2
Other non-current assets	96.7	175.2	262.9	319.5	319.5
<b>Non-current assets</b>	<b>1,024.8</b>	<b>1,122.1</b>	<b>1,140.0</b>	<b>971.3</b>	<b>741.5</b>
<b>Total assets</b>	<b>1,621.6</b>	<b>1,775.4</b>	<b>1,821.5</b>	<b>1,996.8</b>	<b>2,181.8</b>
Trade payables	59.0	59.8	66.3	73.7	79.9
Short-term financial liabilities	164.5	80.1	77.5	86.1	93.4
Current provisions	1.4	1.6	13.6	15.1	16.3
Other current liabilities	301.1	331.4	320.8	356.5	386.5
<b>Current liabilities</b>	<b>526.0</b>	<b>472.9</b>	<b>478.1</b>	<b>531.4</b>	<b>576.1</b>
Non-current financial liabilities	2.2	9.2	11.0	11.0	11.0
Non-current provisions	0.7	2.1	2.2	2.2	2.2
Provisions for employee benefits	16.0	12.4	14.2	13.3	13.7
Deferred tax liabilities	20.1	23.1	21.6	22.4	22.4
Other non-current liabilities	17.2	17.4	17.3	17.4	17.4
<b>Non-current liabilities</b>	<b>56.2</b>	<b>64.3</b>	<b>66.3</b>	<b>66.2</b>	<b>66.7</b>
<b>Total liabilities</b>	<b>582.2</b>	<b>537.2</b>	<b>544.4</b>	<b>597.6</b>	<b>642.8</b>
Issued capital	40.7	40.7	40.7	40.7	40.7
Share premium	126.5	127.5	127.9	127.9	127.9
Other equity interest	(114.5)	(102.6)	(96.1)	(96.1)	(96.1)
Accumulated other comprehensive income	(0.0)	(5.2)	(4.6)	(4.6)	(4.6)
Retained earnings	985.9	1,177.0	1,209.5	1,334.2	1,476.8
Equity attributable to owners of parent	1,038.5	1,237.4	1,277.3	1,402.0	1,544.6
Non-controlling Interests	0.9	0.9	(0.3)	(2.8)	(5.6)
<b>Total equity</b>	<b>1,039.4</b>	<b>1,238.2</b>	<b>1,277.1</b>	<b>1,399.1</b>	<b>1,539.0</b>
<b>Total Liab. and equity</b>	<b>1,621.6</b>	<b>1,775.4</b>	<b>1,821.5</b>	<b>1,996.7</b>	<b>2,181.8</b>

Per-share Performance					
(KRW)	12/14A	12/15A	12/16F	12/17F	12/18F
EPS	3,360	4,622	3,337	4,677	5,120
Adj. EPS	3,360	4,622	3,337	4,677	5,120
BPS	14,001	16,654	17,192	18,869	20,789
SPS	29,068	31,188	32,104	35,016	37,990
GCFPS	6,534	7,821	6,575	7,871	8,293
DPS	2,000	2,800	3,000	3,200	3,200
3yr CAGR of adj. EPS	0.5	11.7	3.5	19.6	9.3

Shareholder Value & Financial Structure					
(%)	12/14A	12/15A	12/16F	12/17F	12/18F
ROE	25.2	30.2	19.6	25.9	25.8
ROA	15.7	20.4	13.9	18.3	18.3
ROIC	27.4	32.6	21.4	31.3	40.7
WACC	3.9	7.2	6.9	6.8	6.8
ROIC/WACC (x)	7.0	4.5	3.1	4.6	6.0
Economic profit (KRWbn)	233.9	280.7	172.8	270.3	312.2
Total liab./equity	56.0	43.4	42.6	42.7	41.8
Net debt/equity	1.3	Net cash	Net cash	Net cash	Net cash
Interest coverage (x)	50.1	159.3	121.4	138.2	133.4

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

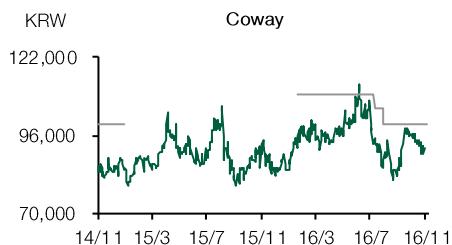
FY-end	12/14A	12/15A	12/16F	12/17F	12/18F
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
OR (KRWbn)	2,160.3	2,315.2	2,373.3	2,601.7	2,822.7
OP (KRWbn)	364.4	463.3	362.2	512.4	558.6
NP (KRWbn)	249.7	343.1	245.6	345.0	377.6
Parent NP (KRWbn)	249.7	343.1	246.7	347.5	380.4
EPS (KRW)	3,360	4,622	3,337	4,677	5,120
Adj. EPS (KRW)	3,360	4,622	3,337	4,677	5,120
PER* (x)	28.2-18.7	23.1-16.2	27.5	19.6	17.9
PBR (x)	6.0	5.0	5.3	4.9	4.4
EV/EBITDA (x)	11.3	9.3	11.7	9.0	8.0
Div. Yield (%)	2.4	3.3	3.3	3.5	3.5
ROE (%)	25.2	30.2	19.6	25.9	25.8
ROIC (%)	27.4	32.6	21.4	31.3	40.7

Note: IFRS-C = Consolidated financial statements; IFRS-P = Individual financial statements

Source: Company data, Hyundai Securities

Disclosures

■ Rating and Target Price Changes



Company	Date	Rating	Target Price (KRW)
Coway	15/12/03	BUY	110,000
	16/07/13	BUY	105,000
	16/08/03	BUY	100,000

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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 September 30, 2016)

BUY	Neutral	Sell
86.1	13.4	0.4

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

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