

Coway (021240.KS)

Domestic business recovery, export expansion, and shareholder-friendly policy brightening 2017 outlook

Company Comment | Feb 16, 2017

Affected by large-scale costs stemming from rental promotion activities, Coway's 4Q16 results missed both our estimates and consensus. But, we forecast that the firm's operating profit will return to a normal growth track in 2017, believing that its bookings of both recall-related costs and lofty promotion expenses were almost completed in 2016. We maintain our Buy rating, believing that Coway's fundamentals will improve gradually on: 1) recovering earnings at its domestic business; 2) expanding exports; and 3) the firm's shareholder-friendly policy stance.

4Q16 review: Earnings miss estimates

On a non-consolidated basis, Coway announced 4Q16 sales of W553.4bn (-5% y-y) and operating profit of W103.8bn (-18% y-y), with both figures falling short of our forecasts and the market projections.

We mainly attribute these estimates-missing figures to higher-than-predicted expenses relating to: 1) a recall of Coway's water purifiers with built-in ice makers; and 2) promotion activities aimed at retaining existing customers and restoring rental demand to pre-recall levels. But, we note that with the booking of recall-related expenses now almost completed, Coway's core indicators normalized in 4Q16—the company's rental sales climbed 5.8% y-y, its rental account growth moved into positive territory, and its customer defection rate fell to 1.26% (vs 1.53% in 3Q16).

Elsewhere, impacted by the recall-related disruption at the company's rental business, 4Q16 sales at the domestic healthcare appliance division shrank 5.3% y-y. However, exports for the quarter came in sound, with ODM sales and sales at overseas subsidiaries expanding by a combined 52% y-y. In particular, sales at Coway's Malaysian subsidiary (the largest contributor to the firm's overall sales amongst consolidated overseas subsidiaries) jumped 61% y-y in 4Q16, backed by smooth business expansion.

2017 operating profit to grow 38% y-y

For 2017, we project non-consolidated sales of W2,503.3bn (+14% y-y) and operating profit of W508.3bn (+38% y-y), anticipating that: 1) Coway's earnings will get back on track on the absence of one-off expenses incurred in 2016; and 2) the firm's exports will expand further (on a spike in the number of its Chinese ODM partners and its efforts to penetrate the Chinese water purifier market in cooperation with the Haier Group).

Positively view shareholder-friendly policy and valuation merit

Despite a y-y decline in its operating profit last year, Coway recently announced that it will distribute a 2016 DPS of W3,200/share (vs W2,800 in 2015). In addition, this year it plans to both distribute an interim dividend and cancel W70bn worth of treasury shares. We predict that this shareholder-friendly policy stance will sustain going forward, noting that: 1) a financial investor is the de-facto major shareholder of Coway; and 2) the company's capex is small relative to its strong cash flow.

With its shares currently trading at a 2017E P/E of 18x, we view the firm as possessing relative valuation merit (vs other consumer goods companies). Given the above-listed positives, we maintain our Buy rating.

Buy (maintain)

TP **W125,000 (maintain)**
CP (17/02/15) **W89,000**

Sector	Other consumer goods
Kospi/Kosdaq	2,083.86 / 615.95
Market cap (common)	US\$5,994.6mn
Outstanding shares (common)	76.4mn
52W high ('16/06/08)	W113,000
low ('16/08/24)	W81,300
Average trading value (60D)	US\$10.93mn
Dividend yield (2016P)	3.62%
Foreign ownership	53.3%

Major shareholders	
Coway Holdings & 8 others	31.3%
GIC Private Limited	7.1%

Share perf	3M	6M	12M
Absolute (%)	1.9	-6.0	-6.8
Relative (%p)	-3.7	-7.5	-16.7

	2015	2016P	2017E	2018F
Sales	2,161	2,205	2,503	2,689
Chg	7.3	2.0	13.5	7.4
OP	463	369	508	519
OPM	21.4	16.7	20.3	19.3
NP to parent	349	274	374	393
EPS	4,531	3,558	4,936	5,192
Chg	43.8	-21.5	38.7	5.2
P/E	18.6	24.8	18.0	17.1
P/B	5.1	5.4	4.9	4.4
EV/EBITDA	9.6	12.9	10.1	9.9
ROE	30.0	21.8	28.5	27.0
Debt/equity	37.3	58.4	56.4	51.4
Net debt	-16	111	70	-27

Units: Wbn, %, won, x
Note: EPS, P/E, P/B, and ROE based on (excl minority interests)
Source: NH I&S Research Center estimates



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4Q16 preview

(Units: Wbn, %)

	4Q15	1Q16	2Q16	3Q16	4Q16P					1Q17E
					Actual	y-y	q-q	Estimate	Consen	
Sales	582.1	577.6	523.0	550.6	553.4	-4.9	0.5	624.9	599.4	615.1
Operating profit	126.8	126.9	21.4	116.6	103.8	-18.1	2.5	114.3	113.2	153.9
Operating margin	21.8	22.0	4.1	21.2	18.8			18.3	18.9	25.0
Pre-tax profit	119.4	121.8	18.0	104.0	114.9	-3.8	10.5	123.7	123.7	149.6
Net profit (excl minority interests)	88.9	92.2	12.3	78.8	86.0	-3.3	9.2	102.6	87.0	119.3

Note: IFRS non-consolidated. Source: Coway, DataGuide, NH I&S Research Center estimates

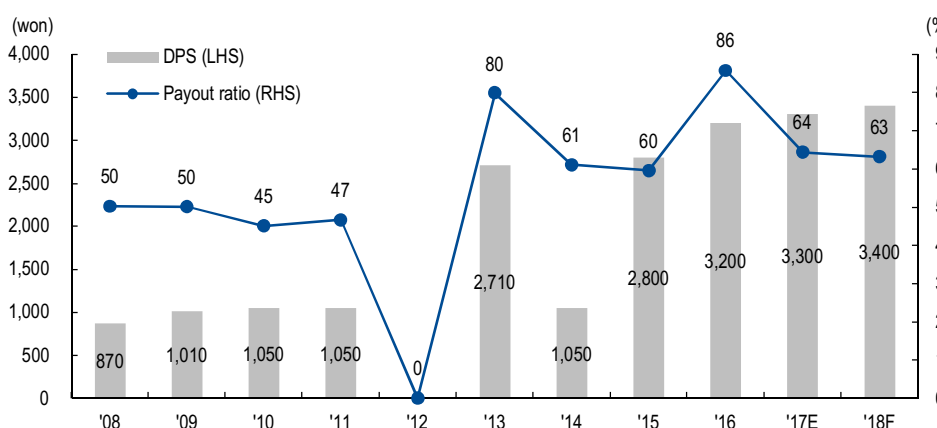
Earnings forecasts (IFRS non-consolidated)

(Units: Wbn, won, x, %)

		2015	2016P	2017E	2018F
Sales	- Revised	2,161.3	2,204.5	2,503.3	2,689.3
	- Previous	-	2,276.1	2,556.1	2,710.6
	- Change	-	-3.1	-2.1	-0.8
Operating profit	- Revised	463.0	368.7	508.3	519.5
	- Previous	-	351.5	528.0	547.0
	- Change	-	4.9	-3.7	-5.0
Operating margin	- Revised	21.4	16.7	20.3	19.3
EBITDA		674.7	531.6	681.3	684.7
Net profit (excl minority interests)		349.4	273.7	374.0	392.6
EPS	- Revised	4,531	3,558	4,936	5,192
	- Previous	-	3,358	5,181	5,523
	- Change	-	6.0	-4.7	-6.0
P/E		18.6	24.8	18.0	17.1
P/B		5.1	5.4	4.9	4.4
EV/EBITDA		9.6	12.9	10.1	9.9
ROE		30.0	21.8	28.5	27.0

Source: NH I&S Research Center estimates

Annual DPS and dividend payout ratio



Note: 1. Due to a court ruling on the disposal of Coway in 2012, its 2012 year-end dividend was paid out as a 2013 interim dividend (₩1,050)

2. Coway has announced its interim dividend plan for 2017 (and thereafter). DPS in the above graph indicates the sum of interim dividends and year-end dividends

Source: Coway, NH I&S Research Center estimates

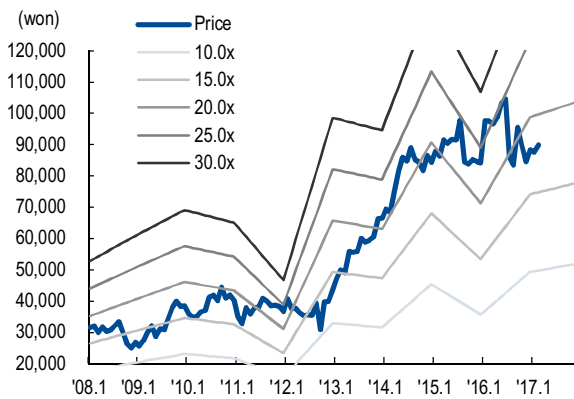
Quarterly earnings forecasts

(Units: Wbn, %)

	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16P	2015	2016P	2017E
Sales	506	527	546	582	578	523	551	553	2,161	2,205	2,503
Rental	363	371	376	380	380	316	367	361	1,491	1,424	1,580
Membership fees	30	41	49	50	46	54	42	40	171	182	209
Lump-sum revenue	30	41	46	54	50	54	43	49	171	196	193
Exports	33	29	36	41	57	60	48	52	139	217	287
Cosmetics	23	21	19	20	20	17	18	19	83	74	75
Financial leases (mattresses)			15	26	21	29	27	28	41	105	137
Other	11	9	10	16	6	5	6	4	46	20	20
Sales growth (y-y, %)	2.7	0.8	10.0	16.5	14.1	-0.9	0.9	-4.9	7.3	2.0	13.6
Rental	6.1	7.0	6.7	6.0	4.6	-14.8	-2.5	-5.1	6.5	-4.5	11.0
Membership fees	-31.7	-9.5	4.5	7.0	52.0	30.6	-14.1	-20.3	-7.0	6.6	15.1
Lump-sum revenue	16.4	10.7	43.5	102.9	68.2	30.6	-6.6	-10.3	40.7	14.3	-1.3
Exports	-27.0	-48.0	8.5	23.9	71.8	106.2	34.4	26.3	-16.8	55.8	32.5
Cosmetics	10.5	-5.3	8.3	1.1	-13.1	-17.9	-2.5	-7.8		-10.7	1.5
Financial leases (mattresses)							81.9	8.8		157.7	30.0
Other	-28.2	-38.6	-31.7	18.1	-45.3	-52.1	-43.4	-72.0	-21.0	-55.6	0.0
Operating profit	99	112	126	127	127	21	117	104	463	369	508
Growth (y-y, %)	10.2	14.4	29.5	36.1	28.3	-80.9	-7.2	-18.1	22.6	-20.4	37.9
Operating margin	19.5	21.2	23.0	21.8	22.0	4.1	21.2	18.8	21.4	16.7	20.3

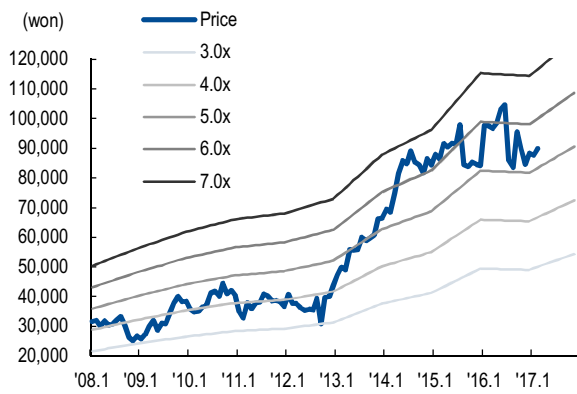
Source: Coway, NH I&S Research Center estimates

Forward P/E band



Source: DataGuide Pro

Trailing P/B band



Source: DataGuide Pro

STATEMENT OF COMPREHENSIVE INCOME

(Wbn)	2015/12A	2016/12P	2017/12E	2018/12F
Sales	2,161	2,205	2,503	2,689
Growth (%)	7.3	2.0	13.5	7.4
COGS	679	748	949	1,043
Gross Profit	1,482	1,456	1,555	1,646
Gross margin (%)	68.6	66.0	62.1	61.2
SG&A	1,019	1,083	1,046	1,127
Operating Income	463	369	508	519
Growth (%)	22.8	-20.3	37.7	2.2
Operating margin (%)	21.4	16.7	20.3	19.3
EBITDA	675	532	681	685
Non-Operating Profits	-2	-10	-14	0
Financial Income(Costs)	-3	-4	-7	-6
Other Non-Operating Profits	1	-20	-15	0
Gains(Losses) in Associates, Subsidiaries and JVs	0	14	8	6
Pre-tax Profit from Cont. Op.	461	363	495	519
Income Taxes	111	89	121	127
Profit from Continuing Op.	349	274	374	393
Net Profit	349	274	374	393
Growth (%)	43.6	-21.5	36.5	5.1
Net margin (%)	16.1	12.4	14.9	14.6
Net Profit of Parent	349	274	374	393
Net Profit to Non-Controlling	0	0	0	0
Other Comprehensive Income	-4	0	0	0
Total Comprehensive Income	346	274	374	393

Valuation / Profitability / Stability

	2015/12A	2016/12P	2017/12E	2018/12F
Price/ Earning (X)	18.6	24.8	18.0	17.1
Price/ Book Value (X)	5.1	5.4	4.9	4.4
Price/ Gross Cash Flow (X)	8.4	12.8	10.0	9.7
Price/ Sales (X)	3.0	3.1	2.7	2.5
EV/ EBITDA (X)	9.6	12.9	10.1	9.9
EV/ EBIT (X)	14.0	18.6	13.5	13.0
Fully diluted EPS (W)	4,531	3,558	4,936	5,192
BVPS (W)	16,459	16,327	18,257	20,169
Sales PS (W)	28,023	28,657	33,035	35,568
ROE (%)	30.0	21.8	28.5	27.0
ROA (%)	21.1	14.7	18.1	17.6
ROIC (%)	32.5	23.4	30.2	29.3
Dividend Yield (%)	3.3	3.6	3.7	3.9
Payout Ratio (%)	59.5	85.7	64.4	63.2
Total Cash Dividend (Wbn)	208	235	241	248
Cash DPS (W)	2,800	3,200	3,300	3,400
Net debt(cash)/ equity (%)	-1.3	8.9	5.1	-1.8
Debt/ equity (%)	37.3	58.4	56.4	51.4
Interest-Bearing Debts (Wbn)	80	280	301	323
Current Ratio (%)	156.1	111.6	124.2	148.0
Total shares (mn)	77	76	76	76
Par value (W)	500	500	500	500
Share price (W)	84,100	88,300	89,000	89,000
Market Cap (Wbn)	6,486	6,744	6,798	6,798

STATEMENT OF FINANCIAL POSITION

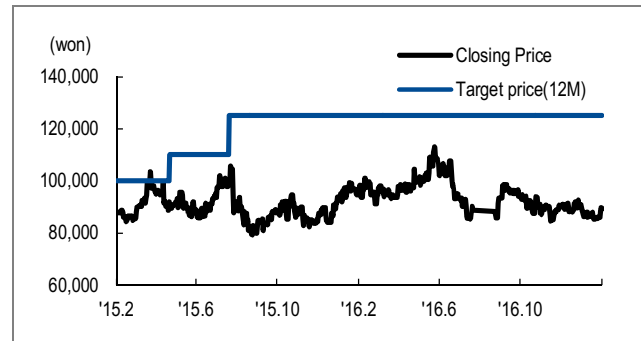
(Wbn)	2015/12A	2016/12P	2017/12E	2018/12F
Cash and Cash Equivalents	87	68	122	234
Accounts Receivables	354	367	417	448
Total Current Assets	658	762	905	1,084
Tangible Assets	625	636	675	646
Investment Assets	122	140	144	148
Non-Current Assets	1,084	1,213	1,253	1,226
Assets	1,742	1,975	2,158	2,309
Short-Term Debt	80	280	301	323
Account Payables	48	50	53	51
Current Liabilities	422	683	729	732
Long-Term Debt	10	1	1	1
Long-Term Allowance	13	14	15	16
Non-Current Liabilities	51	45	49	52
Liabilities	473	728	778	784
Capital Stock	41	41	41	41
Capital Surplus	132	132	132	132
Retained Earnings	1,199	1,206	1,269	1,414
Non-Controlling Interests Equity	0	0	0	0
Shareholders' Equity	1,269	1,247	1,380	1,525

CASH FLOW STATEMENT

(Wbn)	2015/12A	2016/12P	2017/12E	2018/12F
Operating Cash Flow	475	447	495	483
Net Profit	349	274	374	393
Depreciation&Amortization	212	163	173	165
+ Loss(Gains) from Subs	0	0	0	0
+ FC translation loss(profit)	-6	0	0	0
Gross Cash Flow	771	530	674	691
- Incr. (Decr.) in WC	-214	7	-59	-81
Investing Cash Flow	-264	-382	-218	-143
+ Decr. In Tangible Assets	9	0	0	0
- Incr. In Tangible Assets(CAPEX)	-271	-171	-209	-134
+ Disp.(Acq.) of Inv. Assets	1	-18	-4	-4
Free Cash Flow	205	276	286	349
Net Cash Flow	211	65	277	340
Financing Cash Flow	-230	-84	-223	-228
Equity Financing	1	0	0	0
Debt Financing	-231	-84	-223	-228
Incr.(Decr.) in Cash	-19	-18	54	112
Ending Cash and Cash Equivalents	87	68	122	234
Net Debt (Cash)	-16	111	70	-27

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 Feb 10, 2017).

- NH I&S' stock rating distribution

Buy	Hold	Sell
74.4%	25.6%	0.0%

- 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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