

Coway (021240)

Above

In line

Below

12M rating **Hold (Maintain)**

Flat earnings; Keep monitoring overseas business

Stock Data

KOSPI (Nov 1, pt)	2,007
Stock price (Nov 1, KRW)	91,700
Market cap (USD mn)	6,144
Shares outstanding (mn)	76
52-Week high/low (KRW)	113,000/81,300
6M avg. daily turnover (USD mn)	18.3
Free float / Foreign ownership (%)	65.9/54.5
Major shareholders (%)	
Coway Holdings Inc. and 9 others	31.3
GIC Private Ltd.	7.1

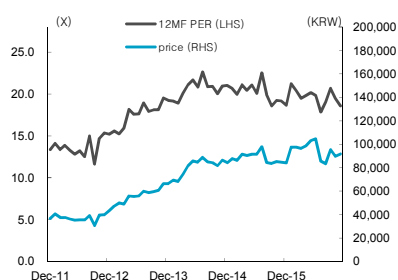
Valuation

	2015A	2016F	2017F
PE (x)	18.2	25.2	18.1
PB (x)	4.8	4.9	4.5
ROE (%)	30.2	21.4	27.7
DY (%)	3.3	3.1	3.5
EV/EBITDA (x)	9.2	11.6	9.2
EPS (KRW)	4,621	3,643	5,065
BPS (KRW)	17,654	18,533	20,231

Performance

	1M	6M	12M
Absolute (%)	(3.9)	(7.0)	7.6
Relative to KOSPI (%p)	(2.1)	(7.7)	8.7

12MF PE trend



Source: WISEfn consensus

What's new: Earnings power intact; Icemaker water purifier issue to cast shadow over 1Q17

Coway reported consolidated 3Q16 sales of W583.5bn (+0.5% YoY) and OP of W107bn (-14% YoY) with an OPM of 18.3% (-3.1%p YoY). Separate OP came in at W116.6bn. Consolidated OP missed our estimate by 17%. Coway booked rental service revenue of W11.3bn that features icemaker water purifier exchanges accompanied by free service for a set period. It also took a W9bn charge to remove unrealized gains. Temporary sales erosion stemming from free service should linger through 1Q17. Rental (rental + membership) sales, stripping out the recall, shrank 2.8% YoY while lump-sum sales fell 6.6% YoY on the shrinking environmental home appliances (EHA) market and cosmetics sales were subdued. Of note, exports had a solid gain of 34% YoY, a bit slower than 1H16, on brisk rental business in Malaysia.

Pros: Stripping out one-offs, lofty profitability and overseas growth potential deserve attention

Profitability was still high with the separate OPM of 21.2% (23.2% stripping out costs related to free service). Tight cost controls continue over labor, advertising, etc. Of note, ad spending fell W7bn YoY on a separate basis. Entering 2016, exports got on a recovery path. Malaysian rental accounts jumped to 390,000, equal to 7% of domestic accounts, with net additions of 49,000 in 3Q16. The Malaysian business has seen cumulative net additions of 117,000 YTD and is forecast to achieve 150,000 in 2016. If the solid growth holds steady, the business should be able to make up for stagnant domestic operations.

Cons: Stagnant domestic business, limited profitability upside

Total subscribers reached 5.73mn accounts, up only 0.1% YoY. New rental sales retreated 16% YoY while the cancellation rate spiked to 1.53%. Subscribers shrank 114,000 QoQ and icemaker water purifier subscriber churn reached 25,000. Among the icemaker water purifier accounts, 76% were retained as re-rentals while other customers likely terminated their accounts. As rental sales and the cancellation rate are steadily improving, subscribers should turn to a net increase in 4Q16. However, year-end subscribers should grow only 0.2% YoY, down from our previous estimate of 1.7% YoY. Stripping out changes to sales and accounting methods following the recall such as 1) rental sales accompanied by free service and 2) lump-sum and finance lease sales, there was no actual growth in 3Q16. The overseas business is growing, which looks positive, but its contribution to profit is marginal. More investment is needed to reap meaningful results.

(W bn, %, %p)

	3Q16P				Change		2016F	
	KIS est.	Actual	Diff.	Consensus	QoQ	YoY	KIS	Consensus
Sales	622	584	(6.2)	606	5.1	0.5	2,412	2,437
OP	129	107	(17.2)	108	804.2	(13.7)	352	362
OP margin	20.8	18.3	(2.4)	17.8	16.2	(3.0)	14.6	14.9
EBT	127	90	(29.1)	106	1,620.4	(26.0)	359	354
NP	96	68	(29.3)	87	2,326.6	(26.6)	271	266

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Conclusion: Stability and attractive dividend are the pros but the con is stagnant earnings

We maintain Hold on Coway. Market dominance, good earnings visibility led by the rental business and a high dividend yield (3.5% in 2017F) are the pros. Shares trade at 18x 2017F PE, which is not high given the probable normalization of earnings. But shares will not likely regain the 20-22x PE, the upper-end of the historical valuation range, while earnings remain stagnant. A recovery for domestic subscriber numbers and the pace of overseas business growth are the critical factors to monitor going forward.

Table 1. Coway earnings

(W bn, %, % YoY)

	2015				2016				Annual				
	1Q	2Q	3Q	4Q	1Q	2Q	3QP	4QF	2014	2015	2016F	2017F	2018F
Sales	548	555	580	631	624	555	584	650	2,160	2,315	2,412	2,647	2,780
% YoY	2.5	(0.3)	10.4	16.3	13.8	(0.1)	0.5	2.9	2.0	7.2	4.2	9.8	5.0
Rental related	409	417	421	424	423	359	409	414	1,584	1,671	1,605	1,716	1,783
% YoY	6.0	6.1	5.3	4.5	3.3	(13.9)	(2.8)	(2.2)	5.1	5.5	(3.9)	6.9	3.9
Rentals	363	371	376	380	380	316	367	372	1,401	1,491	1,435	1,547	1,614
% YoY	6.1	7.1	6.7	6.0	4.6	(14.8)	(2.5)	(2.2)	4.9	6.5	(3.8)	7.8	4.3
Membership	46	45	45	44	43	43	42	43	183	180	170	168	169
% YoY	4.8	(0.7)	(5.1)	(6.8)	(6.7)	(6.4)	(5.4)	(2.4)	6.7	(2.1)	(5.2)	(1.0)	0.4
Finance lease			14.8	26.1	22	29	27	28		41	105	107	117
% YoY			NM	NM	NM	NM	NM	6.9			157	2	9
Lump-sum	30	41	46	54	51	54	43	53	124	171	200	224	253
% YoY	8.8	10.7	43.5	102.7	68.3	30.7	(6.6)	(2.4)	(17.3)	38.6	16.9	11.8	13.1
Cosmetics	23	21	19	20	20	17	18	19	80	83	75	75	75
% YoY	10.2	(5.2)	8.3	1.5	(13.0)	(18.0)	(2.7)	(5.0)	5.3	3.4	(10.0)	0.0	0.0
Exports	33	39	36	42	57	60	48	49	167	149	213	256	307
% YoY	(27.0)	(30.0)	8.5	24.1	71.8	53.3	34.4	17.8	15.8	(10.8)	43.0	20.0	20.0
Others	11	9	10	16	6	5	6	8	58	46	24	24	24
% YoY	(27.7)	(38.9)	(31.4)	14.1	(45.8)	(52.1)	(43.0)	(50.5)	3.9	(21.1)	(48.0)	0.0	0.0
Subsidiaries	53.4	51.3	57.6	76.9	64	62	61	77	202.8	239.2	263.9	297.0	338.7
% YoY	2.7	5.4	33.3	30.6	20.4	20.5	6.3	(0.4)	(5.3)	18.0	10.3	12.5	14.1
OP	100	110	124	129	124	12	107	110	364	463	352	490	523
% YoY	11.1	13.7	30.1	57.4	23.2	(89.3)	(13.7)	(14.6)	7.5	27.1	(24.0)	39.1	6.7
OPM (%)	18.3	19.9	21.4	20.4	19.8	2.1	18.3	16.9	16.9	20.0	14.6	18.5	18.8

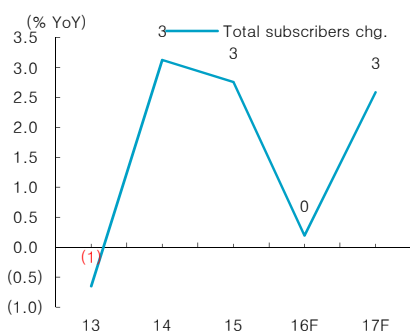
Source: Company data, Korea Investment & Securities

Table 2. Rental business key assumptions

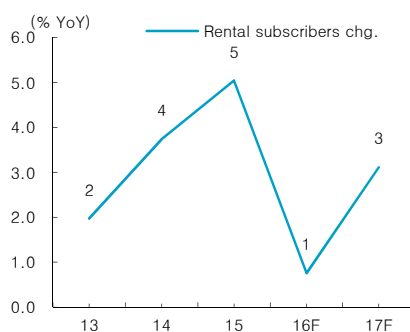
('000 accounts, % YoY, %)

	Annual				
	2014	2015	2016F	2017F	2018F
Total accounts	5,617	5,771	5,783	5,932	6,104
Net additions	170	155	11	149	172
% YoY	3.1	2.8	0.2	2.6	2.9
Rental accounts (year-end)	4,601	4,832	4,869	5,021	5,192
% YoY	3.7	5.0	0.8	3.1	3.4
Net additions	166	232	37	152	171
Membership accounts (year-end)	1,016	939	913	911	912
% YoY	0.4	(7.6)	(2.7)	(0.3)	0.1
Net additions	4	(77)	(25)	(2)	1
New rental sales	1,330	1,409	1,383	1,427	1,479
% YoY	14.1	5.9	(1.8)	3.2	3.6
Churn rate (%)	0.97	1.00	1.10	1.04	1.04
Rental ARPU	25,836	26,345	25,819	26,077	26,337
% YoY	2.0	2.0	(2.0)	1.0	1.0
Membership ARPU	15,073	15,311	15,311	15,388	15,465
% YoY	12.8	1.6	0.0	0.5	0.5

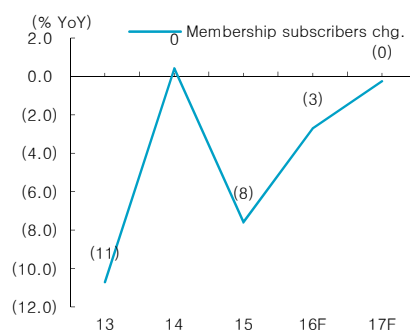
Source: Company data, Korea Investment & Securities

Figure 1. Annual total subscribers

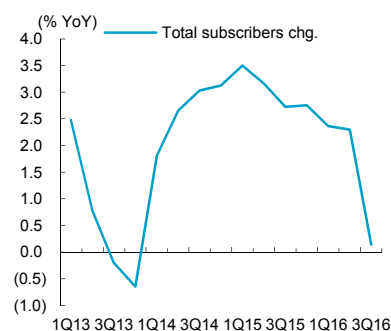
Source: Company data, Korea Investment & Securities

Figure 2. Annual rental subscribers

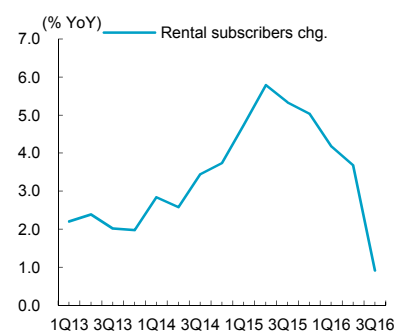
Source: Company data, Korea Investment & Securities

Figure 3. Annual membership subscribers

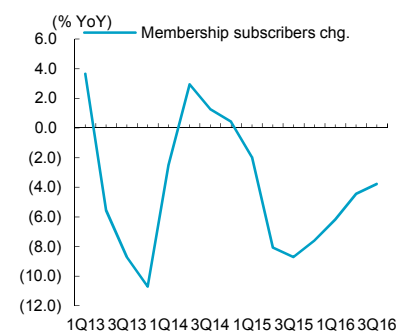
Source: Company data, Korea Investment & Securities

Figure 4. Quarterly total subscribers

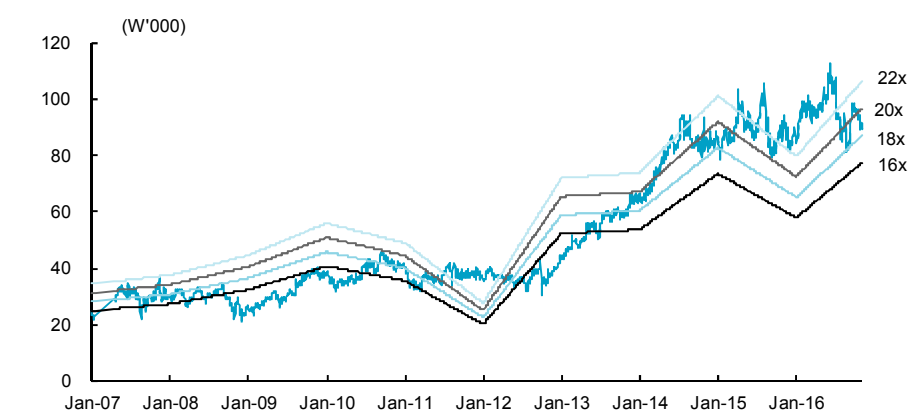
Source: Company data, Korea Investment & Securities

Figure 5. Quarterly rental subscribers

Source: Company data, Korea Investment & Securities

Figure 6. Quarterly membership subscribers

Source: Company data, Korea Investment & Securities

Figure 7. PE band

Source: WISEfn, Korea Investment & Securities

Company overview & Glossary

Established in 1989, Coway is specialized in environmental home appliances (EHA) such as water purifiers, air purifiers and bidets, and has brought EHAs into people's daily lives. Coway was the industry's first to introduce the EHA rental business in 1998. Coway also introduced the maintenance and technician managers (called Cody) to offer standout onsite services. Coway is the leader in Korea with 45% market share for water purifiers, 44% air purifiers, 38% bidets and 62% water softeners, and has strong brand awareness. Coway had approximately 57.7mn accounts (rental + membership) as of end-2015. Coway continues to expand its product lineup to water softeners, food waste treatment systems, mattresses and so on and is stepping up its business drive abroad.

- Rental: Consumers may use the products in exchange for a monthly rental fee along with a one-off registration fee; Contracts usually have a mandatory subscription period of three years while ownership is transferred to the consumer after five years of use; By paying rental fees, consumers are granted access to product use and maintenance services
- Membership: Customers retain product ownership and are offered maintenance services
- ARPU (average sales per user): Monthly average of rental or membership charges paid by customers

Balance sheet

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Current assets	597	653	590	687	805
Cash & cash equivalents	147	116	48	106	195
Accounts & other receivables	229	283	277	291	306
Inventory	62	70	73	80	84
Non-current assets	1,025	1,122	1,164	1,231	1,280
Investment assets	55	54	57	62	65
Tangible assets	675	700	724	748	772
Intangible assets	171	169	176	193	203
Total assets	1,622	1,775	1,754	1,918	2,085
Current liabilities	526	473	395	424	428
Accounts & other payables	251	259	269	296	310
ST debt & bonds	164	80	10	0	0
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	56	64	67	72	75
Debentures	0	0	0	0	0
LT debt & financial liabilities	2	9	9	9	9
Total liabilities	582	537	462	497	504
Controlling interest	1,039	1,237	1,291	1,421	1,580
Capital stock	41	41	41	41	41
Capital surplus	126	127	127	127	127
Other reserves	(114)	(103)	(103)	(103)	(103)
Retained earnings	986	1,177	1,240	1,378	1,546
Minority interest	1	1	1	1	1
Shareholders' equity	1,039	1,238	1,292	1,422	1,581

Cash flow

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
C/F from operations	537	513	498	629	639
Net profit	250	343	271	376	402
Depreciation	206	220	230	240	250
Amortization	8	8	8	9	9
Net incr. in W/C	(29)	(195)	(11)	3	(23)
Others	102	137	0	1	1
C/F from investing	(299)	(329)	(288)	(324)	(316)
Capex	(306)	(329)	(263)	(273)	(283)
Decr. in fixed assets	10	9	9	9	9
Incr. in investment	0	0	(11)	(14)	(12)
Net incr. in intangible assets	(6)	(5)	(15)	(26)	(19)
Others	3	(4)	(8)	(20)	(11)
C/F from financing	(328)	(213)	(278)	(248)	(234)
Incr. in equity	5	5	0	0	0
Incr. in debt	(162)	(77)	(70)	(10)	(0)
Dividends	(124)	(148)	(208)	(208)	(238)
Others	(47)	7	0	(30)	4
C/F from others	(1)	(1)	0	0	0
Increase in cash	(91)	(31)	(68)	58	89

Note: K-IFRS (consolidated)

Income statement

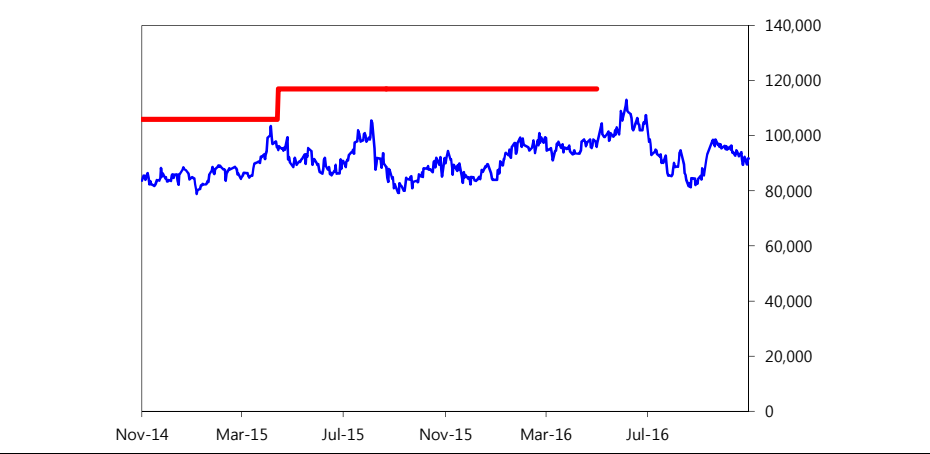
FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Sales	2,160	2,315	2,412	2,647	2,780
COGS	727	729	825	879	912
Gross profit	1,434	1,586	1,587	1,768	1,868
SG&A expenses	1,069	1,123	1,235	1,279	1,345
Operating profit	364	463	352	490	523
Financial income	3	1	1	1	2
Interest income	3	1	1	1	2
Financial expenses	12	4	2	0	0
Interest expenses	12	4	2	0	0
Other non-operating profit	(23)	(6)	7	8	9
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	332	454	359	498	533
Income taxes	83	111	88	122	130
Net profit	250	343	271	376	402
Net profit of controlling interest	250	343	271	376	402
Other comprehensive profit	(9)	(9)	(9)	(9)	(9)
Total comprehensive profit	241	334	262	367	393
Total comprehensive profit of controlling interest	241	334	262	367	393
EBITDA	578	691	590	738	782

Key financial data

FY-ending Dec.	2014A	2015A	2016F	2017F	2018F
Per-share data (KRW)					
EPS	3,361	4,621	3,643	5,065	5,412
BPS	15,146	17,654	18,533	20,231	22,315
DPS	2,000	2,800	2,800	3,200	3,150
Growth (%)					
Sales growth	2.0	7.2	4.2	9.8	5.0
OP growth	7.5	27.1	(24.0)	39.1	6.7
NP growth	1.9	37.4	(21.1)	38.9	6.9
EPS growth	2.4	37.5	(21.2)	39.0	6.9
EBITDA growth	7.6	19.5	(14.6)	25.1	5.9
Profitability (%)					
OP margin	16.9	20.0	14.6	18.5	18.8
NP margin	11.6	14.8	11.2	14.2	14.5
EBITDA margin	26.8	29.8	24.5	27.9	28.1
ROA	15.2	20.2	15.3	20.5	20.1
ROE	25.2	30.2	21.4	27.7	26.8
Dividend yield	2.4	3.3	3.1	3.5	3.4
Dividend payout ratio	59.4	60.6	76.8	63.2	58.2
Stability					
Net debt (W bn)	13	(36)	(39)	(108)	(198)
Int.-bearing debt/equity (%)	16.0	7.2	1.5	0.6	0.5
Valuation (x)					
PE	25.1	18.2	25.2	18.1	16.9
PB	5.6	4.8	4.9	4.5	4.1
EV/EBITDA	11.0	9.2	11.6	9.2	8.5

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Coway (021240)	12-03-14	BUY	W106,000
	04-16-15	BUY	W117,000
	05-04-16	Hold	-



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BUY	Hold	Underweight (Sell)
81.1%	17.6%	1.3%

Note: % of companies under coverage with this rating

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Prepared by: Eun-chaе Na

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