

Studio Dragon (253450 KS)

Media/entertainment



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Rating	BUY (I)
Target price	W60,000 (I)
Current price (Nov 24)	W35,000
Upside potential	71%

IPO price-based market cap	W981bn
Shares outstanding	28,037,240
Largest shareholder	CJ E&M 71.3%

Two growth drivers, China and Netflix

Investment point 1: recovery of distribution revenue in China + α

- From May 2016 (when the company was split off from CJ E&M) to Dec 2016, distribution revenue in China came to W17bn. During the period, mega-hit TV series, such as "The Legend of the Blue Sea" and "Guardian: The Lonely and Great God" were not distributed in China due to the Chinese government's ban on Korean cultural products. The company's TV series distribution revenue in China plunged to W0.6bn in 1H17, and is unlikely to rise much HoH in 2H17.
- In 2018, we expect TV series distribution revenue in China to surge to at least W30bn** (W20bn from low-budget TV series and W10bn from high-budget ones). Distribution of low-budget TV series in Korea will likely recover to the level seen in 2016 thanks to better Korea-Chinese relations. In that case, distribution revenue of low-budget TV series will likely reach W20bn or higher. In addition, we estimate Chinese distribution revenue of its drama "Mr. Sunshine," a 20-episode TV series to air in 2018, at a minimum of W10bn. According to media reports, a Chinese over-the-top TV provider offered \$0.5mn per episode for The Legend of the Blue Sea. Assuming the price of Mr. Sunshine at \$0.5mn per episode, TV series distribution revenue in China would reach \$10mn.

Investment point 2: stronger cooperation with Netflix

- Studio Dragon is expected to work closely with Netflix, especially in 2018, in terms of: **1) licensed distribution of its TV drama series; and 2) production of TV dramas for Netflix.**
- The company sold its new drama series "Stranger" in 2017 to Netflix for W3.8bn. Assuming the same rate applies for its 2018 deals, five new series will likely gross W18.0bn and W36.0bn in the case of 10 series. In addition, the company will likely generate billions of won in additional gross profit if it produces an original series for Netflix (production margin: 15~30%).

Top media content blue chip

- We initiate coverage at BUY and a target price of W60,000**, implying a 2018E EPS of W1,994 and P/E of 30x. Studio Dragon is Korea's biggest TV drama production company, owning licenses to 95 titles in total. The company aims to further enhance its production operations by producing 40 drama series a year in 2020 (22 series in 2017), likely serving non-captive channels, digital platforms, and working together with global peers. We recommend Studio Dragon as our media top-pick.

Quarterly earnings

(Wbn)	4Q17E	% YoY	% QoQ	Consens	vs consens (%)
Sales	78	-	-	-	-
OP	9	-	-	-	-
Pre-tax net profit	11	-	-	-	-
Net profit, CI	8	-	-	-	-
OPM (%)	11.7	-	-	-	-
NPM (%)	10.3	-	-	-	-

Source: Yuanta Securities

Forecasts and valuations (K-IFRS)

	FY ends Dec	2016A	2017E	2018E	2019E
Sales		154	293	380	462
OP		17	39	65	86
Net profit, CI		8	30	54	71
P/E (x)		-	31.6	17.6	13.4
P/B (x)		-	2.5	2.2	1.9
EV/EBITDA		-	-	-	-
ROE (%)		12.0	11.8	13.4	15.2

Note: Figures are for IPO price; Studio Dragon was split off from CJ E&M in May 2016
Source: Yuanta Securities

Summary: beneficiary of recovering revenue in China and enhanced partnership with Netflix

Initiate coverage at BUY
and TP of W60,000

We initiate coverage on Studio Dragon at BUY and a target price of W60,000, implying 2018E EPS of W1,994 and a P/E of 30x. Earnings should grow rapidly in 2018 when TV drama sales to China resume and licensed distribution to Netflix increases. Studio Dragon is Korea's biggest TV drama producer and is trying to expand its global business amid the growing global OTT market.

The November Korea-China summit officially signaled the lifting of China's ban on Korean media content. Although 1H17 sales to China came to just W600mn due to the ban, sales to China will likely reach W30.0bn in 2018. TV drama production costs are usually recouped by programing and other revenue in most cases. When sales to China recover in earnest, the company's operating leverage should be amplified.

Cooperation with Netflix will likely be enhanced from 2018 as well in terms of license distribution and production of original drama series. The two companies have yet to finalize how many series to distribute and produce. 1) In the case of licensing dramas, revenue per series is estimated at W3.6bn for 2018 assuming Netflix applies the same rate it did for "Stranger" in 2017. With just five series, Studio Dragon will be able to book about W18.0bn (W3.6bn x 5 series). 2) We estimate production margin for Netflix original series at 15%~30%, as Netflix may be willing to pay much more than Korean producers for a TV series. By producing for Netflix, Studio Dragon will be able to generate billions of won for a series without any production cost risk.

Positive news flow
expected around the
lock-up expiry of Feb
2018

Studio Dragon went public on Nov 24, 2017, issuing 6mn new shares without any secondary offering. This pushed the number of shares outstanding from 22.04mn to 28.04mn. Of the 28.04mn shares, 21% or 5.88mn are free float, but 2.18mn of the 5.88mn are locked up, leaving **3.70mn shares or 13% of outstanding shares tradable. Of the shares locked up, 25% or 1.15mn shares (4% of shares outstanding) will be released three months after the offering on Feb 26, 2018 (since Feb 24 is a Saturday).** This may weigh on the share price. Yet, high-ranking Chinese officials will likely visit Korea for the closing ceremony of the Pyeongchang Winter Olympic Games the day before Feb 26, as China is hosting the next winter games in 2022. This should heighten expectations for the successful release and sales of the company's blockbuster drama series such as Mr. Sunshine in 1H18. Positive news flow will likely offset the impact of the locked up shares being released.

[Table 1] Ownership structure post IPO

			No of shares (shares)	Ownership stake (%)	Length of lock-up
Locked-up	CJ E&M		20,000,000	71.3	6 months
	Kim Seon Jung (Culture Depot CEO)		636,360	2.3	6 months
	Yoon Harim (Hwa & Dam Pictures CEO)		545,450	1.9	6 months
	Jang Jin Wook (KPJ CEO)		30,000	0.1	6 months
	Other		825,430	2.9	6 months
	Subtotal		22,037,240	78.6	-
	ESOP		120,000	0.4	1 year
	Total shares locked up		22,157,240	79.0	-
Tradable	Publish offering	Institutions	4,680,000	16.7	-
		Others	1,200,000	4.3	-
		Subtotal	5,880,000	21.0	-
Total			28,037,240	100.0	-

Source: Company data

[Table 2] Studio Dragon: new share allocation

Shareholder	No of shares	In percentage	Price/share (won)	Total paid (Wbn)	Remarks
ESOP	120,000	2%		4.2	Preferred allocation
Individual	1,200,000	20%	35,000	42.0	-
Institutions	4,680,000	78%		163.8	Including high risk high return investment trust allocations
Total	6,000,000	100%		210.0	-

Source: Company data

[Table 3] Shares locked up by period

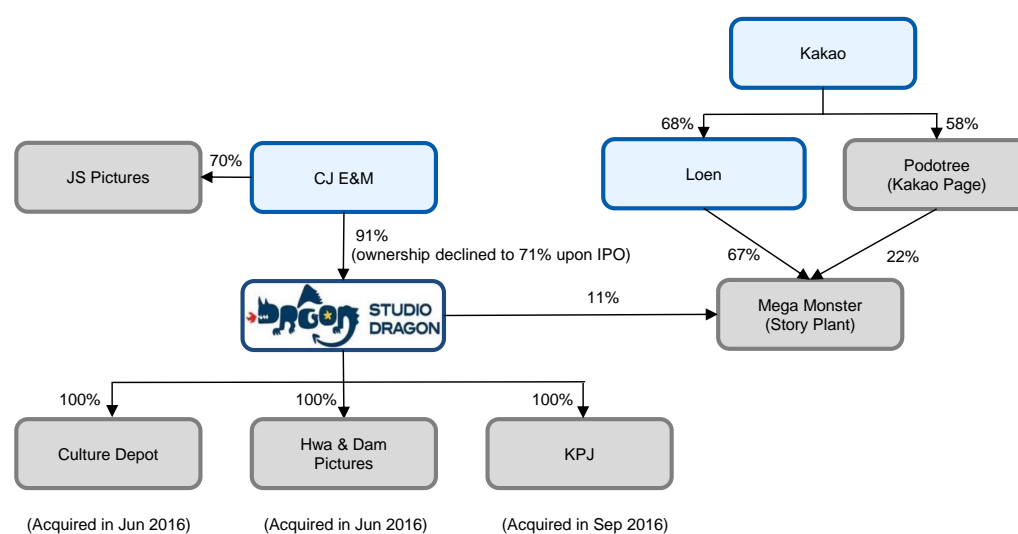
Custodial period	No of shares	Of shares allocated to institutions
15 days	179,340	3.8%
1 month	404,241	8.6%
3 months	1,153,160	24.6%
6 months	437,404	9.3%
Tradable shares	2,505,855	53.5%
Total	4,680,000	100.0%

Source: Company data

[Table 4] Studio Dragon: investment plan for the fresh fund (Wbn)

	Object	2018	2019	2020	Total
Investments	Blockbuster drama series production	22.0	24.0	20.2	66.2
	Recruiting key creators; enhancing business fundamentals	15.0	65.0	20.0	100.0
	Total	37.0	89.0	40.2	166.2

Source: Company data

[Fig 1] Studio Dragon: ownership structure

Source: Company data, Yuantia Securities

Valuation

2018E P/E of 30x

Our target price of W60,000 implies 2018E EPS of W1,994 and a P/E of 30x. The P/E multiple of 30x is based on the 12-month-forward P/E average of the top-five Chinese TV drama production companies (P/E 32.5x) listed on the Shenzhen Stock Exchange over 2016~17 (Hauce, Huayi Brothers, HualuBaina, Zhejiang Talent, New Culture).

We expect net profit to post a CAGR of 34% over 2018~2020, climbing from W54.3bn to W97.3bn, which supports our target P/E multiple of 30x.

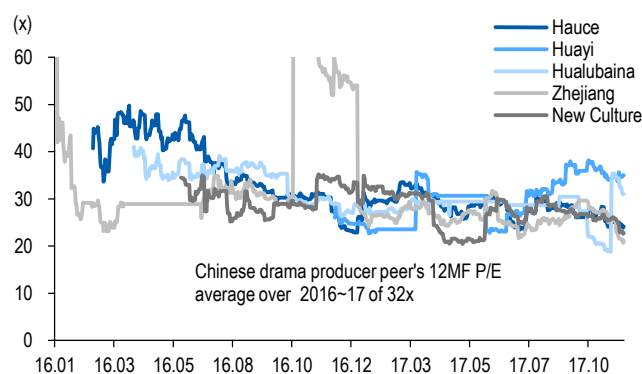
[Table 5] Studio Dragon: peer valuation of earnings and valuation

	Ticker	Unit	Mkt cap	2017E			2018E			2019E		
				Revenue	OP	NP	Revenue	OP	NP	Revenue	OP	NP
Studio Dragon	253450 KS	(Wbn)	981	293	39	30	380	65	54	462	86	71
CJ E&M	130960 KS	(Wbn)	3,583	1,798	90	482	2,053	125	196	2,229	160	241
Hauce	300133 CH	(\$mn)	2,646	807	106	93	970	134	113	1,146	165	139
Huayi Brothers	300027 CH	(\$mn)	3,439	584	147	132	717	192	153	856	227	173
HualuBaina	300291 CH	(\$mn)	1,481	333	-	43	385	-	54	430	-	62
Zhejiang Talent	300426 CH	(\$mn)	1,230	243	72	57	301	109	80	418	146	114
New Culture	300336 CH	(\$mn)	1,019	223	57	47	292	77	63	354	93	70
				2017E			2018E			2019E		
				P/E	P/B	ROE	P/E	P/B	ROE	P/E	P/B	ROE
Studio Dragon		(x, %)		31.6	2.5	11.8	17.6	2.2	13.4	13.4	1.9	15.2
CJ E&M		(x, %)		6.6	1.5	26.8	16.2	1.4	9.1	13.2	1.3	10.2
Hauce		(x, %)		27.4	2.5	9.0	21.7	2.3	9.9	18.6	2.0	10.6
Huayi Brothers		(x, %)		26.8	2.3	8.4	22.0	2.1	9.5	20.2	2.0	9.4
HualuBaina		(x, %)		26.2	1.5	4.4	21.1	1.4	5.3	17.6	1.4	5.9
Zhejiang Talent		(x, %)		21.6	5.9	27.5	16.6	4.2	29.8	11.7	3.1	28.9
New Culture		(x, %)		20.7	2.0	9.7	16.3	1.8	11.3	14.3	1.6	11.3
Chinese peer avg		(x, %)		24.5	2.8	11.8	19.5	2.4	13.2	16.5	2.0	13.2

Note: Studio Dragon and CJ E&M figures are our estimates. Peer figures are consensus based.

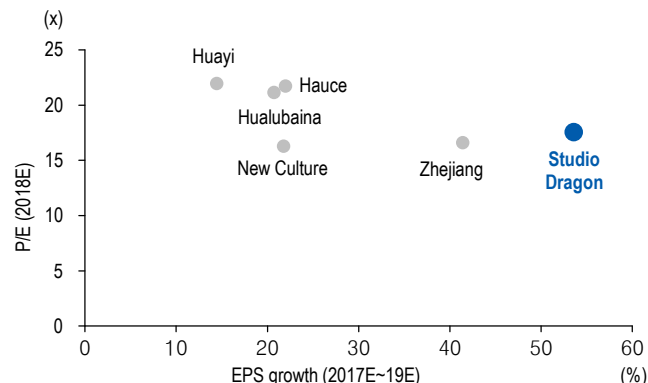
Source: Bloomberg, Yunta Securities

[Fig 2] Chinese peer 12-month-forward P/E



Source: Bloomberg, Yunta Securities

[Fig 3] Peer comparison of P/E – EPS growth



Source: Bloomberg, Yunta Securities

Earnings forecast: 2018E OP W65.2bn (+69% YoY)

2017E revenue W293bn
(+50% YoY),
OP W38.6bn (+82% YoY),
NP W30.1bn

We estimate 2017 consolidated revenue at W293bn (+50% YoY), OP at W38.6bn (+82% YoY), and NP at W30.1bn. By division, programming revenue will likely come to W101.7bn (+16% YoY), distribution W134.3bn (+78% YoY), and “other” W57.1bn (+77% YoY). 1) We assume programming revenue will rise in proportion to the number of TV series produced, which is likely to increase from 19 in 2016 to 22 in 2017 (+16% YoY). 2) We estimate 2017 full-year distribution revenue based on 1H17 revenue of W63bn. The number of episodes of the company’s TV series aired will likely rise from 140 in 1H17 to 250 in 2H17 (+79% HoH), as CJ E&M’s cable network tvN has added a Wednesday–Thursday drama slot to its schedule and Studio Dragon’s TV series have also begun to air on non-captive channels, such as multi-content channels and terrestrial TV networks. We estimate 2H17 distribution revenue at W71.3bn, considering both the HoH increase in the number of episodes to air in 2H17 and base effect from the distribution of “The Legend of the Blue Sea” and “Guardian: The Lonely and Great God” in Japan and Northeast Asia in 1H17. Among 2017 annual distribution revenue, **we estimate domestic revenue at W51.8bn (+66% YoY) and overseas revenue at W82.5bn (+87% YoY).** 3) Other revenue is the sum of product placement (PPL), DVD, OST, and merchandise revenue, and artist agency revenue at Culture Depot, a consolidated talent agency subsidiary. In 1H17, other revenue came to W27.3bn (drama-related revenue W13bn and artist agency revenue W14.3bn), while we estimate 2H17 other revenue at W29.8bn (drama W15.5bn, agency W14.3bn), factoring in the HoH increase in the number of episodes to air in 2H17 and base effect from overseas sales of The Legend of the Blue Sea and Guardian in 1H17. We assume agency revenue among other revenue will remain flat HoH in 2H17.

2018E revenue W379.5bn (+30%
YoY), OP W65.2bn (+69% YoY),
NP W54.3bn (+80% YoY)

We estimate 2018 consolidated revenue at W379.5bn (+30% YoY), OP at W65.2bn (+69% YoY), and NP at W54.3bn (+80% YoY). By division, programming revenue will likely come to W120.1bn (+18% YoY), distribution W189.3bn (+41% YoY), and other W70bn (+23% YoY). We assume programming and other revenue will rise in proportion to the number of TV series the company produces. According to company guidance, the number of TV series productions is set to rise to 25–28 in 2018. We assume the number of TV series produced by the company in 2018 at 26 (+18% YoY). We expect domestic distribution revenue to rise from W51.8bn in 2017 to W62.2bn in 2018 (+20% YoY), and overseas distribution revenue to **soar from W82.5bn in 2017E to W127.3bn in 2018 (+54% YoY).** For domestic distribution revenue, we considered the impact of the higher number of TV series produced. In estimating overseas distribution revenue, we assumed that distribution revenue in China will rise by at least W30bn YoY and Netflix revenue will also show a meaningful increase YoY.

We assume TV series production cost for 2018 at W200.2bn, and 80% of the cost will be recouped by programming and other revenue and the remaining 20% by distribution revenue. We also assume most of the distribution revenue, excluding the 20% production cost and 15% distribution commission paid to CJ E&M, is recognized as gross profit, other expense is identical to other revenue, and artist agency revenue does not generate any profit.

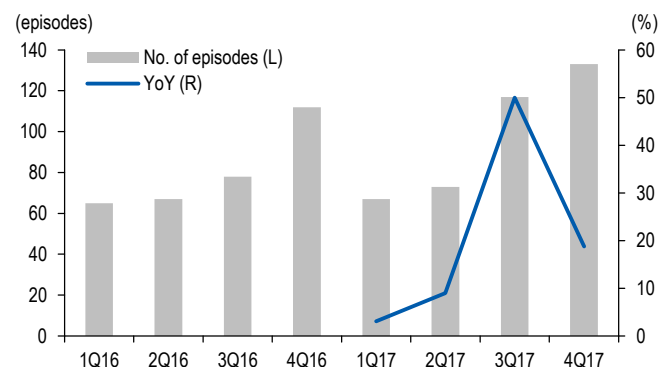
[Table 6] Studio Dragon: earnings forecast

(Wbn)

	Quarterly				Half-year				Full-year							
	1Q17	2Q17	3Q17E	4Q17E	1H16	2H16	1H17	2H17E	2014	2015	2016	2017E	2018E	2019E	2020E	
No of TV series produced	-	-	-	-	-	-	-	-	-	16	19	22	26	33	40	
Revenue	75.3	62.1	77.5	78.1	66.1	129.4	137.4	155.6	103.1	97.4	195.5	293.0	379.5	462.1	555.1	
- Programming	-	-	-	-	-	-	47.1	54.6	58.1	54.8	87.8	101.7	120.1	152.5	184.8	
- Distribution	-	-	-	-	-	-	63.0	71.3	40.2	39.0	75.4	134.3	189.3	230.8	283.4	
- Others	-	-	-	-	-	-	27.3	29.8	4.8	3.6	32.3	57.1	70.0	78.8	86.9	
Growth (YoY)	-	-	-	-	-	-	-	-	-	-6	101	50	30	22	20	
- Programming	-	-	-	-	-	-	-	-	-	-6	60	16	18	27	21	
- Distribution	-	-	-	-	-	-	-	-	-	-3	93	78	41	22	23	
- Others	-	-	-	-	-	-	-	-	-	-25	797	77	23	13	10	
Domestic distribution revenue	-	-	-	-	-	-	24.3	27.5	15.5	15.1	31.2	51.8	62.2	71.5	82.2	
Overseas distribution revenue	-	-	-	-	-	-	38.7	43.8	24.7	23.9	44.2	82.5	127.3	159.4	201.3	
Domestic distribution revenue (% YoY)	-	-	-	-	-	-	-	-	-	-3	107	66	20	15	15	
Overseas distribution revenue (% YoY)	-	-	-	-	-	-	-	-	-	-3	85	87	54	25	26	
COGS	58.6	49.9	67.6	65.3	56.3	112.0	108.5	132.9	94.7	91.1	168.3	241.4	298.7	357.4	413.8	
COGS-to-sales (%)	78	80	87	84	85	87	79	85	92	94	86	82	79	77	75	
- Production cost	-	-	-	-	-	-	-	-	-	-	-	-	200.2	244.0	284.4	
- Distribution commission (paid to CJ)	-	-	-	-	-	-	-	-	-	-	-	-	28.4	34.6	42.5	
- Other	-	-	-	-	-	-	-	-	-	-	-	-	70.0	78.8	86.9	
Gross profit	16.8	12.2	9.9	12.8	9.8	17.4	28.9	22.7	8.4	6.3	27.2	51.7	80.8	104.7	141.3	
Gross margin	22	20	13	16	15	13	21	15	8	6	14	18	21	23	25	
SG&A expense	2.8	3.3	3.3	3.6	1.3	4.7	6.1	6.9	4.2	3.7	6.0	13.0	15.6	18.7	22.5	
SG&A-to-sales (%)	4	5	4	5	2	4	4	4	4	4	3	4	4	4	4	
Operating profit	14.0	8.9	6.6	9.2	8.5	12.7	22.9	15.8	4.2	2.6	21.2	38.6	65.2	86.0	118.9	
Operating margin	19	14	9	12	13	10	17	10	4	3	11	13	17	19	21	
Pre-tax profit	13.2	9.0	7.9	10.5	-	-	22.2	18.5	-	-	-	40.6	71.6	93.6	128.3	
Pre-tax margin	18	14	10	13	-	-	16	12	-	-	-	14	19	20	23	
Net profit	9.6	6.5	6.0	8.0	-	-	16.2	14.0	-	-	-	30.1	54.3	71.0	97.3	
Net margin (%)	13	11	8	10	-	-	12	9	-	-	-	10	14	15	18	
Growth (% YoY)																
Revenue	-	-	-	-	-	-	108	19	-	-6	101	50	30	22	20	
Operating profit	-	-	-	-	-	-	169	24	-	-38	715	82	69	32	38	
Net profit	-	-	-	-	-	-	-	-	-	-	-	-	80	31	37	

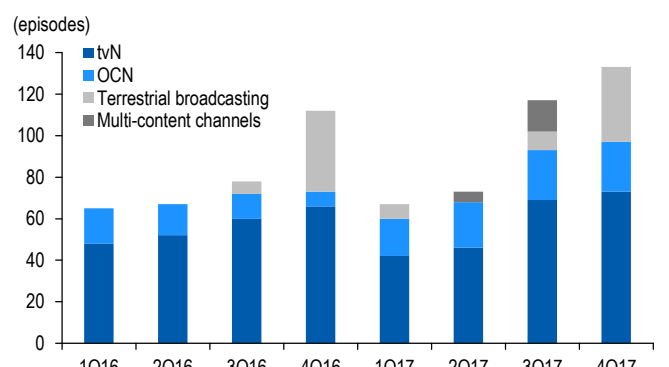
Note: Studio Dragon was split off from CJ E&M in May 2016; figures for 2016 includes CJ E&M's drama production division earnings for January~April; pre-split-off earnings were supervised by KPMG Korea, Source: Yuanta Securities

[Fig 4] Studio Dragon: quarterly number of episodes aired



Source: Yuanta Securities

[Fig 5] Studio Dragon: quarterly no of episodes aired, by channel



Source: Yuanta Securities

[Table 7] Studio Dragon: revenue by region**(Wbn)**

	1H16	2H16	1H17	Note
Revenue	66.1	129.4	137.4	-
- Korea	-	102.0	107.4	-
- China	-	15.3	0.6	Exports plunge in 1H17 as China bans Korean cultural products in 2017
- Japan	-	4.8	12.1	The Legend of the Blue Sea and Guardian sold in 1Q17
- US	-	0.9	2.3	-
- Others	-	6.5	14.9	The Legend of the Blue Sea and Guardian sold in 1Q17; Stranger distribution revenue from Netflix partly recognized in 2Q17

Source: Company data, Yuanta Securities

[Table 8] Studio Dragon: overseas revenue**(Wbn)**

	1H17	2H17E	2014	2015	2016	2017E
TV series distribution revenue	63.0	71.3	40.2	39.0	75.4	134.3
1) Domestic	24.3	27.5	15.5	15.1	31.2	51.8
2) Overseas	38.7	43.8	24.7	23.9	44.2	82.5
- Japan	12.0	-	5.5	8.9	9.1	-
- Asia	21.2	-	15.6	11.0	32.3	-
- US	5.3	-	3.2	3.6	2.6	-
- Others	0.2	-	0.4	0.4	0.2	-

Source: Company data, Yuanta Securities

[Table 9] Studio Dragon: earnings of consolidated subsidiaries**(Wbn)**

		2014	2015	2016	1H17
Hwa & Dam Pictures	Revenue	13.1	7.3	10.4	13.6
	Net profit	1.7	-2.5	-1.5	5.2
	Net margin	13%	-34%	-14%	38%
Culture Depot	Revenue	34.2	34.9	42.7	27.8
	Net profit	2.4	1.5	2.1	3.4
	Net margin	7%	4%	5%	12%
KPJ	Revenue	-	0.3	-	4.4
	Net profit	-	0.1	-0.2	-0.1
	Net margin	-	35%	-	-3%

Source: Company data, Yuanta Securities

[Table 10] CJ E&M's consolidated subsidiaries: income statement**(Wbn)**

	Studio Dragon		Hwa & Dam Pictures		Culture Depot		KPJ	
	Revenue	Net profit	Revenue	Net profit	Revenue	Net profit	Revenue	Net profit
2Q16	25.0	4.5	-	-	-	-	-	-
3Q16	37.9	5.4	0.6	-0.5	9.6	0.6	-	-
4Q16	74.0	-0.5	9.9	-0.6	8.4	0.7	-	-0.1
1Q17	67.4	8.0	12.6	6.7	20.1	2.9	-	-0.2
2Q17	54.8	4.4	1.0	0.0	7.6	-	4.4	-0.2
3Q17	70.0	4.7	2.4	-1.0	6.2	-0.1	-	-0.1
2016	136.9	9.4	10.5	-1.0	18.0	1.3	-	-0.1

Source: CJ E&M, Yuanta Securities

2018 investment point 1: recovery of distribution revenue in China + α

TV series distribution revenue in China over May~Dec 2016: W17bn

From May 2016 (when it was split off from CJ E&M) to Dec 2017, Studio Dragon's TV series distribution revenue should come to W17bn. It is quite a high figure, given that TV series sales in China began to shrink in 2H16. During the period, mega-hit TV series such as The Legend of the Blue Sea and Guardian: The Lonely and Great God were not distributed in China, as the Chinese government banned Korean cultural content. In 2016, only "Entourage" generated meaningful revenue in China. We expect the company to be able to at least generate the same amount of revenue from low-budget dramas as in 2016 in China.

The company's TV series distribution revenue in China plunged to W0.6bn in 1H17, as the Chinese government banned Korean cultural content, and is unlikely to rise much HoH in 2H17.

[Table 11] Studio Dragon: revenue by region

(Wbn)

	May~Dec 2016	1H17	Note
Revenue	154.4	137.4	-
- Korea	121.1	107.4	-
- China	17.0	0.6	Exports plunge in 1H17 as China bans Korean cultural products in 2017
- Japan	6.4	12.1	The Legend of the Blue Sea and Guardian sold in 1Q17
- US	2.3	2.3	-
- Others	7.6	14.9	The Legend of the Blue Sea and Guardian sold in 1Q17; Stranger distribution revenue from Netflix partly recognized in 2Q17

Source: Company data, Yuanta Securities

TV series distribution revenue in China likely to reach at least W30bn in 2018

We expect TV series distribution revenue in China to reach at least W30bn (low-budget TV series W20bn + high-budget W10bn) in 2018. As China's ban on Korean cultural content seems to have been lifted after the Korea-China summit in Nov 2017, we believe the distribution revenue of low-budget TV series in 2018 will recover to at least the level seen in 2016. In 2016, the company's monthly average distribution revenue stood at W2.1bn, which annualized comes to W25.5bn. In short, we expect the company to generate at least W20bn in distribution revenue from low-budget dramas in China in 2018. In addition, a high-budget TV series will likely generate about W10bn in distribution revenue. In total, distribution revenue in China will likely reach at least W30bn in 2018, taking into account blockbuster drama Mr. Sunshine.

1) Expectations for 2018 blockbuster “Mr. Sunshine”

Mr. Sunshine expected to air in April or Jun 2018


Studio Dragon is preparing to release a blockbuster titled Mr. Sunshine in 1H18. Screenwriter Kim Eun Sook and Director Lee Eung Bok joined hands again after they successfully completed Descendants of the Sun. Given that weekend drama series schedules are already programed until Apr 2018 (“A Korean Odyssey” until Dec 2017 and “Live” until Feb 2018), **Mr. Sunshine will likely be released in April or Jun 2018.**

[Fig 6] Studio Dragon’s blockbuster TV series “Mr. Sunshine”

Mr. Sunshine (2018, tvN, 20 episodes)


Production: Hwa & Dam Pictures
Script: Kim Eun Sook, Director: Lee Eung Bok

A story of a young boy who travels to the US during the 1871 Shinmiyangyo (US expedition to Korea) and returns to his homeland later as an American soldier




Kim Eun Sook Lee Eung Bok


[Cast]




Lee Byung Hun




Kim Tae ri



Yoo Yeon seek



Byeon Yo Han



Cho Woo Jin

Source: Yuantia Securities

We believe The Legend of the Blue Sea and Guardian: The Lonely and Great God posted sales of W29.3bn and W25.8bn, respectively. Even without sales in China, their ROI came to 33% and 61%. If they were sold to China, margin would have been higher. This is why we have high hopes for Mr. Sunshine.

[Table 12] Studio Dragon: revenue from existing TV series

[Table 12] Studio Dragon: revenue from existing TV series						(Wbn)
Title		Period	Estimated production cost (A)	ROI(B) (actual)	Project revenue [C=Ax(1+B)]	Project profit (C-A)
The Legend of the Blue Sea	SBS 20 episodes	Nov 16, 2016~Jan 25, 2017	22.0	33%	29.3	7.3
Guardian: The Lonely and Great God	tvN 16 episodes	Dec 02, 2016~Jan 21, 2017	16.0	61%	25.8	9.8

Source: Company data, Yuantia Securities

Price of Korean TV drama sold to China rose steadily since 2013

The price of Korean TV dramas sold to China has risen rapidly since 2013, when OTT service provider iQIYI's successful streaming of "My Love from the Star", which generated massive advertising VOD (AVOD) revenue, drew attention to the value of Korean TV dramas.

To be specific, the price per episode rose from \$35,000 for "My Love from the Star", to \$250,000 for Descendants of the Sun and to \$400,000 for "Moon Lovers". According to media reports, **a Chinese buyer offered \$500,000 per episode for "The Legend of the Blue Sea" in 2016.**

[Table 13] Sales price of hit Korean dramas to China over 2014~16

Title	Broadcaster	Aired	Production	Price per episode (\$'000)	Buyer
My Love from the Star	SBS	2013.12~2014.2	HB Entertainment	35	iQIYI
The Next Three Days	SBS	2014.3~2014.5	Goldthumb Pictures	50	Youku Tudou
Doctor Stranger	SBS	2014.5~2014.7	Aura Media	80	Youku Tudou
It's Okay, That's Love	SBS	2014.7~2014.9	GT Entertainment, CJ E&M	120	Youku Tudou
My Lovely Girl	SBS	2014.9~2014.11	Acetory	200	Youku Tudou
Bad Guys: Reloaded	OCN	2014.10~2014.12	Urban Works	100	Youku Tudou
Pinocchio	SBS	2014.11~2015.1	IHQ	280	Youku Tudou
The Producers	KBS2	2015.5~2015.6	Chorokbaem Media	200	Sohu
Descendants of the Sun	KBS2	2016.2~2016.4	NEW	250 + RS	iQIYI
Uncontrollably Fond	KBS2	2016.7~2016.9	Samhwa Networks, IHQ	250	Youku Tudou
Moon Lovers	SBS	2016.8~2016.11	Wind	400	Youku Tudou

Source: media reports, Yuanta Securities

Mr. Sunshine **will likely air about a year and a half after** The Legend of the Blue Sea. Given the recent growth of Chinese OTT players, Mr. Sunshine **should be sold at a higher price than** The Legend of the Blue Sea.

Mr. Sunshine total sales likely at least \$10mn

Even if we assume that the same rate is offered for **Mr. Sunshine, total sales will at least be \$10mn (\$0.5mn x 20 episodes),**

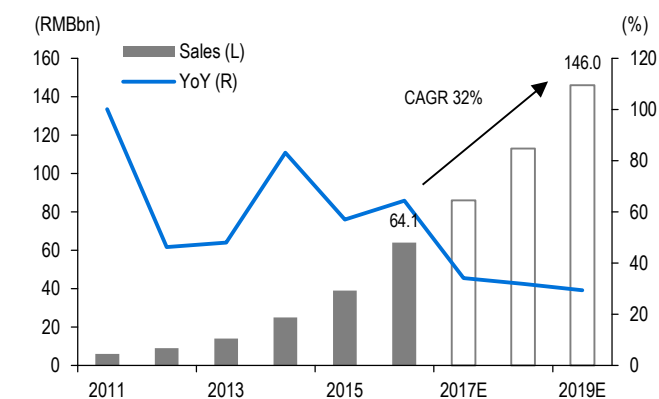
2) Chinese OTT market growth → TV drama sales price to China likely to trend up

Chinese online video market to post CAGR of 32% over 2016~19

iResearch forecasts that the Chinese online video market will expand from RMB64.1bn in 2016 to RMB146.0bn in 2019, posting a CAGR of 32%. By segment, advertising VOD (AVOD) sales will post a CAGR of 23% over 2016~2019, growing from RMB35.2bn to RMB65.8bn. Subscription VOD (SVOD) sales will likely grow faster at a CAGR of 65% over 2016~2019 from RMB12.4bn to RMB56.1bn.

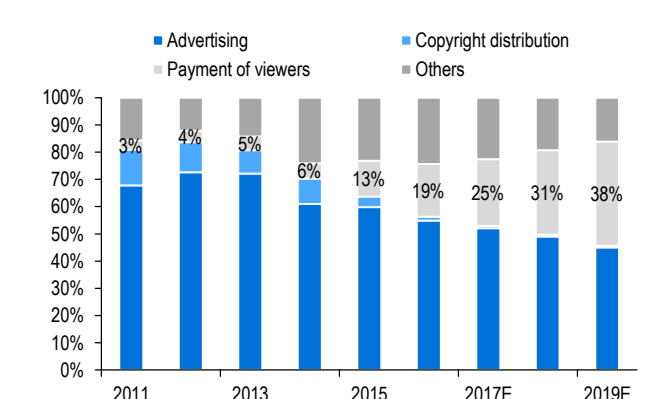
Paying subscribers for Chinese OTT operators have grown explosively since 2015. This is because iQIYI and other major OTT operators in China are providing paid streaming services for just RMB15 a month. Despite slowing growth of the AVOD market, SVOD has emerged as a new growth engine, which should help sustain rapid growth of the Chinese OTT market.

[Fig 7] Chinese online video market sales



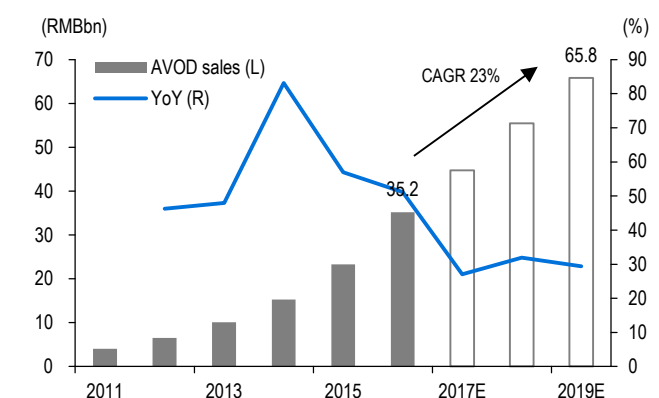
Source: iResearch

[Fig 8] Online video sales breakdown



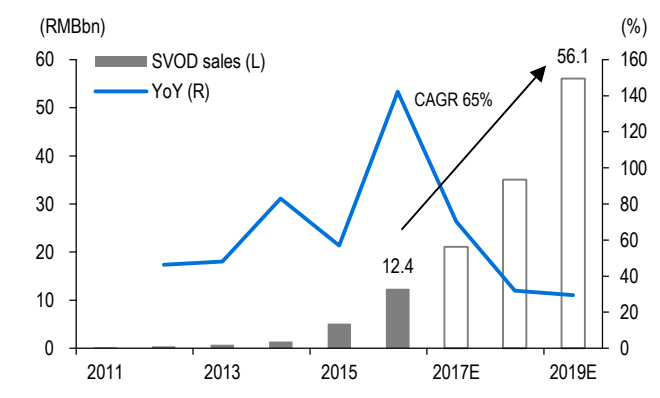
Source: iResearch

[Fig 9] China's AVOD market sales



Source: iResearch

[Fig 10] China's SVOD market sales



Source: iResearch

[Fig 11] Monthly flat payment rate plan of iQIYI (SVOD): RMB15 per month



Source: iQIYI, Yuanta Securities

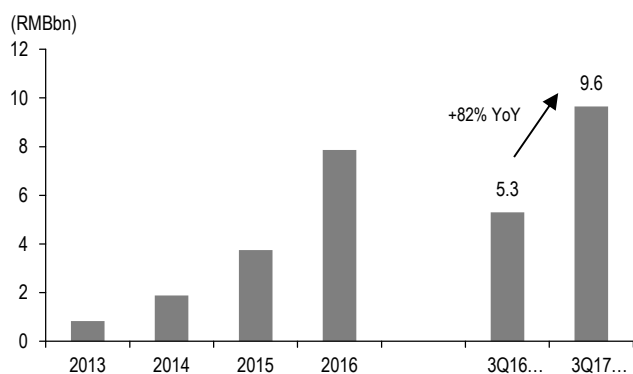
Continuously growing content investment by Chinese OTT operators

→ Korean TV drama sales prices likely to increase further

Like in the AVOD market, **quality content is the key to competitiveness in SVOD**. The global SVOD leader, Netflix, grew its paying subscribers to over 100mn thanks to original content such as "House of Cards." **Chinese OTT operators are also seeking superior content, either developed in-house or imported exclusively, to expand their subscription base.**

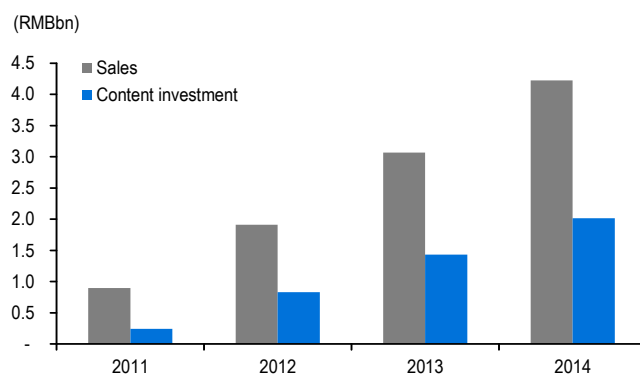
We looked into content investment by Baidu, which owns iQIYI and video application PPS to assess how actively Chinese OTT firms are pursuing quality content. Content investment at Baidu climbed from RMB1.9bn in 2014 to **RMB3.7bn in 2015 and RMB7.9bn in 2016**. **Over 1Q~3Q17, content investment likely grew 82% YoY to RMB9.6bn**. Content investment also grew at Youku Tudou every year over 2011~2014. Although its 2015~2017 investment figures are not available, as it was acquired by Alibaba in Apr 2016 and delisted, it is very likely to have trended up. **Growing investment by Chinese OTT operators should push up the price of Korean TV drama sales.** Korean TV drama content is a relatively cheap tool for them to boost traffic.

[Fig 12] Baidu's content investment (iQIYI+ PPS)



Source: Baidu

[Fig 13] Youku Tudou's content investment



Note: Alibaba took over Youku Tudou in 4Q15

Source: Youku Tudou

All four major Chinese OTT platforms have a Korean drama section, be it SVOD or AVOD. Some of the uploaded series are aired exclusively by one operator. For example, Descendants of the Sun is exclusively aired on iQIYI.

[Fig 14] Chinese OTT service providers have designated pages for Korean TV dramas



Source: iQIYI, Yuanta Securities

Some of Studio Dragon's dramas produced since 2015 exclusively air on major Chinese OTT operators: five on Youku, one on iQIYI, and one on Tencent Video. In the case of Entourage, it was pre-produced before the first episode went online simultaneously on tvN and Tencent Video. **Entourage is expected to have made the biggest sales contribution among those exported to China over May~Dec 2016 (total sales in China: W17.0bn).** If Mr. Sunshine also airs simultaneously in Korea and China, its contribution to 2018 sales should be even greater than expected.

3) Sales of TV series library sales

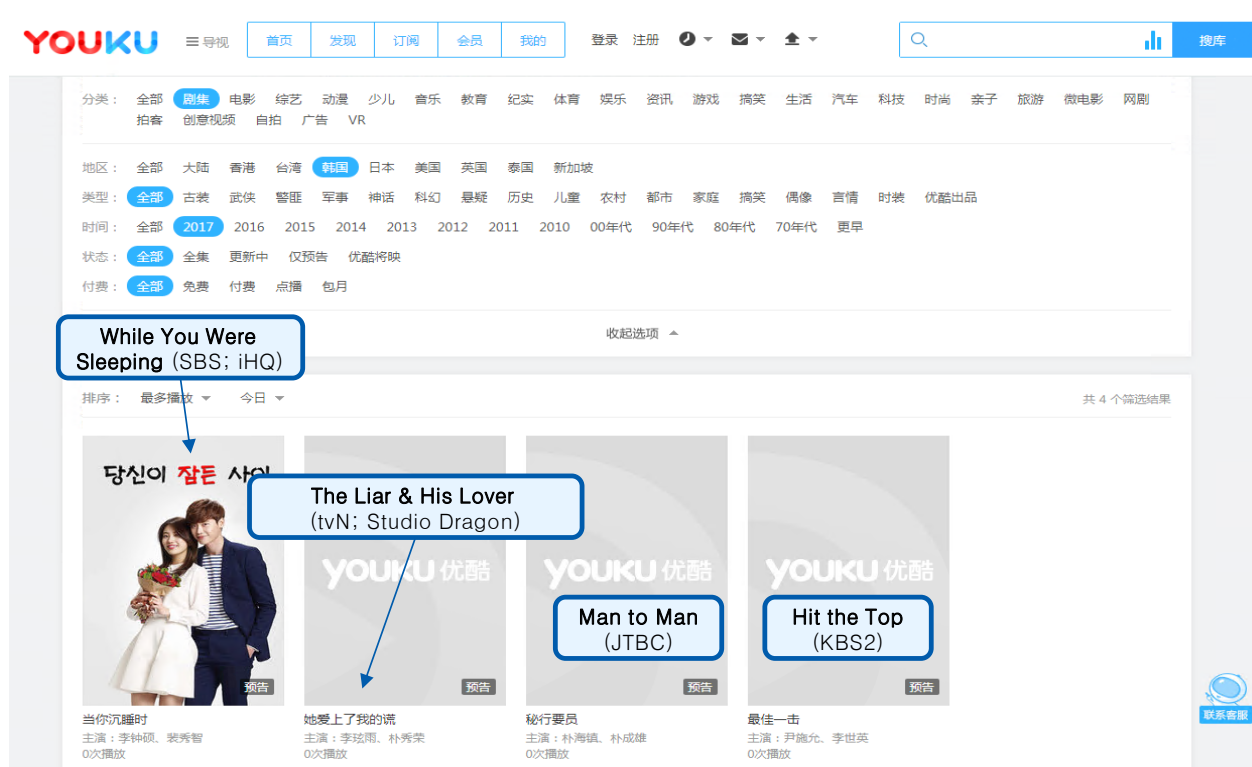
Big pool of TV series sellable to China

Studio Dragon has not sold many TV series to Chinese OTT content providers. **From 2015 to 2016, it produced 35 TV series. Among them, we estimate that the company only sold nine to iQiyi, eight to Tencent, and seven to Youku.** Thus, it has a big pool of TV series to sell.

In the Korean drama sections of Chinese OTT content sites, only a trailer is uploaded for a number of TV series. Tencent Video has trailers for The Legend of the Blue Sea and Guardian: The Lonely and Great God, which have not been sold to any Chinese OTT content providers. We believe sales of these TV series were discussed but cancelled or delayed due to the Chinese government's ban on Korean cultural content. **Many of Studio Dragon's TV series aired in 2015~2017 have a trailer uploaded on Chinese OTT content providers' website: 11 on Tencent, and 3 on Youku.** As China's ban on Korean cultural content has been lifted, these TV series will likely be sold soon.

Interestingly, four Korean TV series aired in 2017 have their trailers uploaded on Youku. Among the four is Studio Dragon's "The Liar & His Lover," which implies that negotiations are underway between Studio Dragon and Youku over sales of the TV series aired in 2017.

[Fig 15] Youku's Korean TV series section has trailers of four Korean TV series aired in 2017



Source: Youku, Yunta Securities

2018 investment point 2: tighter cooperation with Netflix

Netflix begins to buy Korean dramas in earnest

Netflix began to actively purchase Korean TV series in 2017. Netflix purchased Drama House's *Man to Man* and Studio Dragon's *Stranger* for high prices in 2017. According to reports, **Netflix bought *Man to Man* for \$350,000 per episode and *Stranger* for \$200,000.** The contract for these two series includes exclusive distribution rights in more than 190 countries other than Korea and China and a condition that the series will air simultaneously on Netflix and TV networks.

Netflix also bought FNC Add Culture's web drama series "My Only Love Song." Chinese OTT content provider Sohu was supposed to buy the series for RMB850,000 (W140mn) per episode, but the contract was terminated in Mar 2017, as it was uncertain when the platform would begin to air the drama. Netflix purchased the series for \$75,000 per episode for exclusive distribution rights to the series in more than 190 countries excluding China for 24 months.

[Table 14] The per-episode price of Korean TV series purchased by Netflix

Producer	Title	Network	No of episodes	Aired	Per-episode price
Drama House	Man to Man	JTBC	16	2017.04.21~2017.06.10	\$350,000
Studio Dragon	Stranger	tvN	16	2017.06.10~2017.07.30	\$200,000
FNC Add Culture	My Only Love Song (web drama)	-	20	-	\$75,000

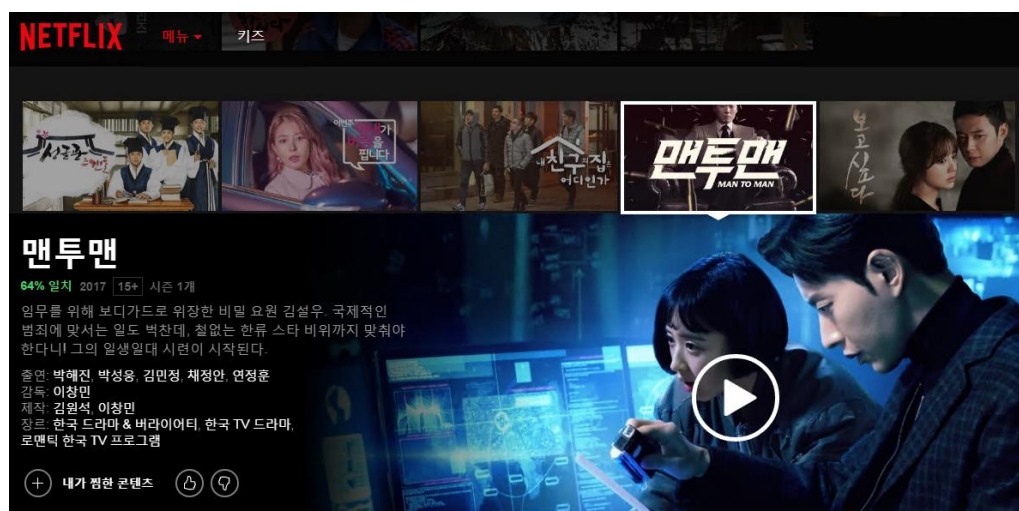
Source: Media reports, Yunta Securities

[Fig 16] Netflix's global coverage: services in more than 190 countries excluding China



Source: Netflix

[Fig 17] Man to Man 1st Korean drama to air simultaneously on Korean TV network and Netflix



Source: Netflix

In addition to Stranger, Studio Dragon sold its old TV series library in 2017. Based on dramas uploaded on Netflix, we estimate that Studio Dragon sold 13 of its old drama series. Mega-hit dramas such as The Legend of the Blue Sea and Guardian: The Lonely and Great God were excluded from the library sales.

[Table 15] List of dramas produced by Studio Dragon and sold to Netflix

	Title	Network	No of episodes	Aired	Note
New	Stranger	tvN	16	2017.06.10~2017.07.30	Sold for about W3.6bn in total
Library	Miss Ripley	MBC	16	2011.05.30~2011.07.19	-
	I Need Romance	tvN	16	2011.06.13~2011.08.02	-
	Birdie Buddy	tvN	24	2011.08.08~2011.10.25	-
	A Gentleman's Dignity	SBS	20	2012.05.26~2012.08.12	-
	I Need Romance2	tvN	16	2012.06.20~2012.08.09	-
	Reply 1997	tvN	16	2012.07.24~2012.09.18	-
	9: Nine Time Travels	tvN	20	2013.03.11~2013.05.14	-
	Reply 1994	tvN	21	2013.10.18~2013.12.28	-
	I Need Romance3	tvN	16	2014.01.13~2014.03.04	-
	Gap-dong	tvN	20	2014.04.11~2014.06.21	-
	It's Okay, That's Love	SBS	16	2014.07.23~2014.09.11	-
	The Incomplete	tvN	20	2014.10.17~2014.12.20	-
	Oh My Ghostess	tvN	16	2015.07.03~2015.08.22	-

Source: Netflix, Yuanta Securities

1) Drama distribution license deals

14% of new Studio Dragon dramas aired in 2017 likely to be distributed by Netflix


Studio Dragon sells the distribution licenses for drama series whose intellectual property it wholly owns. Stranger, which aired in 2017, is a leading example. Currently, Studio Dragon is negotiating distribution license agreements for new dramas "Black" and A Korean Odyssey with Netflix. Black began airing on OCN in Oct 2017 and will end in Dec 2017. As simultaneous airing is impossible, we expect the price of Black to be decided at a lower level than Stranger. However, A Korean Odyssey will begin airing on tvN in Dec 2017. If simultaneous airing becomes possible, the price of the drama series will likely be similar to that of Man to Man and Stranger. **If Black and A Korean Odyssey are sold to Netflix, Studio Dragon will have sold three TV series, or 14% of its 22 series aired in 2017 to Netflix.**

[Fig 18] tvN's upcoming drama "A Korean Odyssey"

A Korean Odyssey (2017; tvN)

To air in Dec 2017
Produced by Studio Dragon and JS Pictures
Written by the Hong sisters (Jeong-eun, Miran), directed by Hong-gyun Park


A modern spin-off of the Chinese classic novel "Journey to the West."





Writer
Jeong-eun Hong


Writer
Mi-ran Hong


[Cast]


Seung-gi Lee


Seung-won Cha


Yeon-seo Oh


Hong-gi Lee


Se-young Lee

Source: Yuenta Securities

New drama distribution portion via Netflix likely to rise in 2018

Studio Dragon plans to raise its portion of new dramas distributed to Netflix in 2018. In this case, a significant number of new dramas can be sold at the price of Stranger (about W3.6bn in total). Assuming the company sells upcoming dramas to air in 2018 at the same price as Stranger, the company will be able to generate W18bn for five series or W36bn for 10 series.

[Table 16] 2018 sales estimate depending on number of new dramas distributed via Netflix (Wbn)

1 drama	2	3	4	5	6	7	8	9	10
3.6	7.2	10.8	14.4	18.0	21.6	25.2	28.8	32.4	36.0
11	12	13	14	15	16	17	18	19	20
39.6	43.2	46.8	50.4	54.0	57.6	61.2	64.8	68.4	72.0

Note: Assuming the dramas will be sold at the same price to Stranger

Source: Yuenta Securities





2) Netflix original drama production

Likely to produce Netflix original dramas in 2018

Studio Dragon is also in discussions to produce and supply Netflix original TV series from 2018. If a deal is struck, **Studio Dragon will supply drama series at a 15~30% production margin** and Netflix would own the intellectual property.

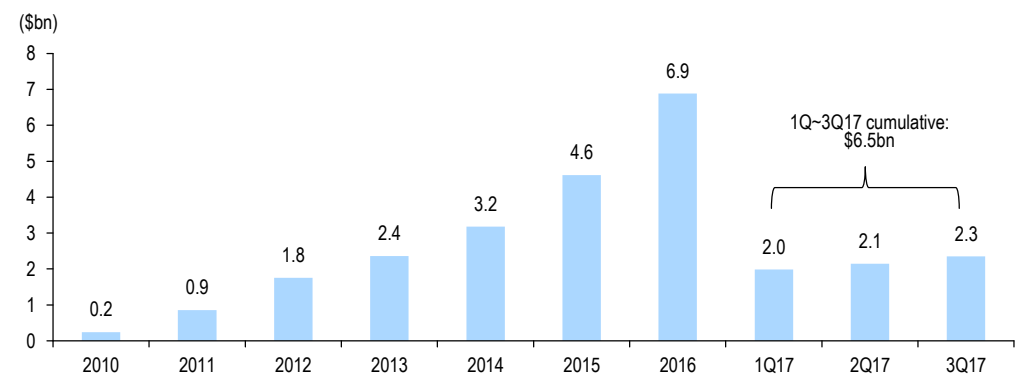
Studio Dragon's gross margin came to 14% in 2016 and 21% in 1H17. Production margin of 15~30% means gross margin of 15~30%. It is a business that can generate a similar margin to the company's existing drama production business. Considering that Netflix invested about \$50mn in the film "Okja," a film released in 2017, we expect Netflix to set the original drama production budget at quite a high level. The budget for "Kingdom," an upcoming 6-episode Netflix original drama to be produced by Astory in 2018, is known to be more than W10bn. **For Netflix original dramas, the cost risk is shouldered by Netflix. Studio Dragon should generate higher revenue the more Netflix original dramas it produces and the higher their budget is.**

[Fig 19] Two Netflix original dramas to air in 2018

Kingdom (6-episode)	Love Alarm (12-episode)
<p>Produced by Astory Production budget: W10bn +α Written by Eun-hee Kim, Directed by Seong-hun Kim</p> <p>A crown prince of the Joseon Dynasty is sent on a mission to investigate a mysterious plague spreading across the country.</p>	<p>Based on Gye-young Chon's popular webtoon Directed by Jae-mun Lee</p> <p>A software developer creates an app that alerts users if anyone nearby harbors romantic feelings for them.</p>
<div data-bbox="165 1189 347 1391"></div> <div data-bbox="389 1189 571 1391"></div> <div data-bbox="612 1189 794 1391"></div> <div data-bbox="213 1395 293 1420">Ji-hun Ju</div> <div data-bbox="405 1395 549 1420">Seung-ryong Ryu</div> <div data-bbox="660 1395 740 1420">Doona Bae</div>	<div data-bbox="1027 1189 1203 1413"></div>

Source: Yuanta Securities

[Fig 20] Netflix: global cash spending on streaming content



Source: Netflix, Yuanta Securities

Studio Dragon (253450 KS) pro forma financial statements (K-IFRS)

Statement of comprehensive income					
FY ends Dec (Wbn)	2016A	2017F	2018F	2019F	2020F
Sales	154	293	380	462	555
Cost of sales	133	241	299	357	414
Gross profit	22	52	81	105	141
SG&A	5	13	16	19	22
Operating profit	17	39	65	86	119
EBITDA	39	39	65	86	119
Non-op profit/loss	-6	2	7	8	10
Forex gain/loss	0	0	0	0	0
Net interest income	-1	2	7	8	10
Equity-meth gain/loss	0	0	0	0	0
Other	-5	0	0	0	0
Net prof before income tax	10	40	72	94	129
Income tax	2	10	17	23	31
Net profit from continuing ops	8	20	54	71	98
Net profit from discontinued ops	0	0	0	0	0
Net profit	8	30	54	71	98
NP for controlling interest	8	30	54	71	98
Total comprehensive income	8	21	55	71	98
Total comprehensive income, CI	8	21	55	71	98

Note: Operating profit calculation same as K-GAAP (sales - COGS - SG&A exp)

Statement of financial position					
FY ends Dec (Wbn)	2016A	2017F	2018F	2019F	2020F
Current assets	81	337	400	477	581
Cash & cash equivalents	12	279	336	407	504
Accts rec & other	39	19	24	29	35
Inventory	0	2	3	4	4
Non-current assets	161	170	170	170	170
Tangible assets	1	1	1	1	1
Investment in affiliates	0	0	0	0	0
Other non-current	2	2	2	2	2
Total assets	242	507	571	648	751
Current liabilities	84	120	130	135	141
Accts payable & other	20	36	45	50	57
ST financial liabilities	8	7	7	7	7
Liquid LT liabilities	0	20	20	20	20
Non-current liabilities	21	11	11	11	11
LT financial liabilities	0	0	0	0	0
Debentures	20	10	10	10	10
Total liabilities	106	131	140	146	152
Equity, controlling interest	136	376	431	502	600
Paid-in capital	11	14	14	14	14
Capital surplus	115	322	322	322	322
Retained earnings	8	38	92	164	261
Equity, non-controlling interest	0	0	0	0	0
Total equity	136	376	431	502	600
Net debt	16	-243	-300	-371	-468
Total debt	28	36	36	36	36

Cash flow statement					
FY ends Dec (Wbn)	2016A	2017F	2018F	2019F	2020F
Operating cash flow	-12	41	58	71	97
Net profit	8	13	55	71	98
Depreciation & amortization	0	0	0	0	0
Forex gain/loss	0	0	0	0	0
Affiliate invest gain/loss	0	0	0	0	0
Inc (dec) in net working cap	-46	28	3	0	0
Other	25	0	0	0	0
Investing cash flow	-70	0	0	0	0
Investment	0	0	0	0	0
Inc in tangible assets	-1	0	0	0	0
Dec in tangible assets	0	0	0	0	0
Other	-68	0	0	0	0
Financing cash flow	93	210	0	0	0
Inc (dec) in ST fin liab	7	0	0	0	0
Inc (dec) in LT fin liab	20	0	0	0	0
Inc (dec) in equity	56	210	0	0	0
Cash dividend	0	0	0	0	0
Other	10	0	0	0	0
Other cash flow	0	28	0	0	0
Inc (dec) in cash & equivalents	12	279	58	71	97
Beginning cash & equivalents	0	0	279	336	407
Ending cash & equivalents	12	279	336	407	504
NOPLAT	17	39	65	86	119
FCF	-12	56	52	65	90

Valuation					
FY ends Dec	2016A	2017F	2018F	2019F	2020F
EPS (won)	5,691	1,108	1,946	2,608	3,575
BPS (won)	61,763	13,841	15,834	18,442	22,017
EBITDA/shr (won)	27,127	1,420	2,398	3,160	4,368
SPS (won)	107,949	10,767	13,948	16,982	20,398
DPS (won)	0	0	0	0	0
P/E (x)	-	31.6	17.6	13.4	9.8
P/B (x)	-	2.5	2.2	1.9	1.6
EV/EBITDA (x)	-	-	-	-	-
P/S (x)	-	3.3	2.5	2.1	1.7

Key financial data					
FY ends Dec	2016A	2017F	2018F	2019F	2020F
Sales (% YoY)	0.0	89.7	29.5	21.8	20.1
Operating profit (%YoY)	na	132.3	68.9	31.8	38.2
Net profit, CI (%YoY)	na	270.1	80.0	30.8	37.1
Gross margin (%)	14.0	17.6	21.3	22.7	25.5
Operating margin (%)	10.8	13.2	17.2	18.6	21.4
Net margin, CI (%)	5.3	10.1	14.4	15.4	17.6
EBITDA margin (%)	25.1	13.2	17.2	18.6	21.4
ROIC (%)	21.8	27.1	54.0	72.2	99.3
ROA (%)	6.7	7.9	10.1	11.7	14.0
ROE (%)	12.0	11.8	13.4	15.2	17.7
Debt-to-equity (%)	77.8	34.9	32.6	29.0	25.3
Net debt-to-equity (%)	12.1	-64.5	-69.7	-73.9	-78.1
OP/financing cost (x)	19.5	0.0	0.0	0.0	0.0

Note: CI = controlling interest

EPS, BPS, P/E and P/B are based on controlling interest

For valuation metrics such as P/E, historical figures are based on annual average prices and estimates, on current price

For ROA or ROE, assets and equity are averages of end-of-year figures for the given year and the year prior

Source: Yuanta Securities

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Total	100.0

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