

Studio Dragon (253450 KQ)

HJ Kim

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Rating **MARKETPERFORM**
maintain

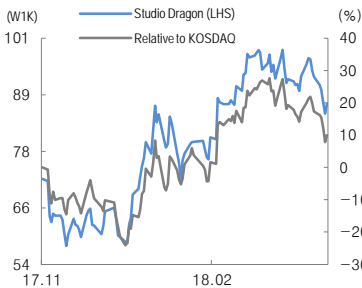
6M TP (₩) **81,000**
raise

CP (₩)
(18.04.27) **87,400**

Media

KOSDAQ	886.49
Market cap (₩bn)	2,450
Market cap portion (%)	0.75
Paid-in capital (common; ₩bn)	14
52w high/low (₩)	98,600 / 57,800
120d avg. trading volume (₩bn)	30.1
Foreign ownership (%)	0.96
Major shareholders	CJ E&M+3: 75.66%

(%)	1M	3M	6M	12M
Abs. return	-10.5	2.6	0.0	0.0
Rel. return	-13.2	5.7	0.0	0.0



Long-term approach recommended

MARKETPERFORM reiterated; 6M TP raised 9% to ₩81,000

- Our residual income model values Studio Dragon at ₩81,000 per share. This is 9% higher than our previous target price, which reflects the upgrade of our forecast for the company's annual average growth until 2022 from 29% to 31%. But we keep MARKETPERFORM on it as 2018E P/E stands as high as 43x, even assuming that the relations between Korea and China improve and the company exports two dramas to China for a total of ₩20bn.

1Q18 results: earnings to rise gradually and more slowly than expected

- 1Q18 revenue expanded 6% yoy and 11% qoq to ₩79.9bn. OP fell 24% yoy, but rose 208% qoq to ₩10.7bn.
- *A Korean Odyssey*, *Hwayuki* performed strongly, recording a maximum viewership rating of 7% and landing a sales contract with Netflix. In contrast, *Cross*, *Children of a Lesser God*, and *My Mister* recorded poor sales due to removal and replacement of the cast.
- *Live*, currently on the air, has recorded a maximum viewership rating of 7.1% and been sold to Netflix. Revenue and earnings will keep increasing led by growth in production: The number of shows produced rose by 13 yoy to 102 in 1Q18. However, no China deals, which are required to elevate earnings to a higher plane, have been made yet.
- Our 2018E OP of ₩70.5bn is based on the assumption that Studio Dragon will export two shows to China (for ₩10bn each). The current share price reflects too high expectations for China deals, which have yet to be made. Investors should wait and see if the company's dramas actually fetch good prices. *Mister Sunshine* and *Memories of Alhambra Palace*, which are to be aired in 2H18, are the two strongest candidates.

(₩bn, %)										
	1Q17	4Q17	Previous estimate	Result	1Q18			2Q18		
					YoY	QoQ	Consensus	Daishin estimate	YoY	QoQ
Revenue	75	72	77	80	6.1	11.1	87	68	9.3	-15.1
OP	14	3	10	11	-23.6	208.4	14	13	43.1	18.9
NP	13	2	9	8	-40.0	302.4	12	11	292.5	36.8

	2016	2017	Previous estimate	Daishin estimate	2018(F)		Growth	
					Chg	Consensus	2017	2018(F)
Revenue	154	287	341	343	0.3	384	85.7	19.4
OP	17	33	72	71	-2.5	70	98.3	113.8
NP	8	24	58	57	-2.7	54	192.9	138.6

Source: Studio Dragon, WISEfn, Daishin Securities Research Center

Operating results and major financial data (Wbn, W, x, %)

	2016A	2017A	2018F	2019F	2020F
Revenue	154	287	343	366	387
OP	17	33	71	78	92
Pretax profit	10	30	77	87	101
NP	8	24	57	64	75
NP (controlling int.)	8	24	57	64	75
EPS	5,691	1,050	2,030	2,286	2,660
PER	-	61.9	43.1	38.2	32.9
BPS	61,763	13,141	15,171	16,857	18,817
PBR	-	4.9	5.8	5.2	4.6
ROE	12.0	9.5	14.3	14.3	14.9

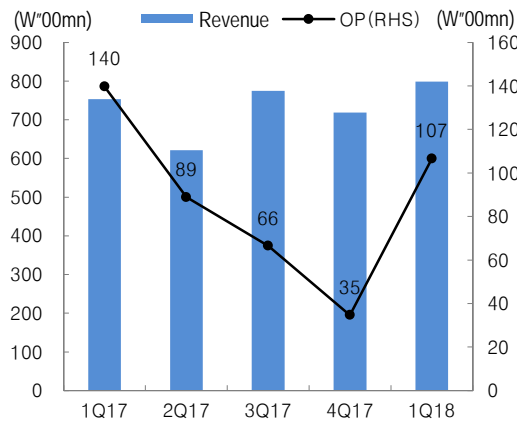
Note: EPS, BPS, and ROE are based only on the controlling interest.
Source: Studio Dragon, Daishin Securities Research Center

Yearly earnings forecast revision (Wbn, W, %, %p)

	Previous		Revised		Chg	
	2018F	2019F	2018F	2019F	2018F	2019F
Revenue	341	370	343	366	0.3	-1.0
S&A expense	9	10	11	13	27.2	24.8
OP	72	85	71	78	-2.5	-7.6
OP margin	21.2	22.9	20.6	21.4	-0.6	-1.5
Non-operating profit	8	9	7	8	-21.1	-3.0
Pretax profit	81	93	77	87	-4.4	-7.2
NP (controlling int.)	58	68	57	64	-2.7	-5.3
NP margin	17.1	18.3	16.6	17.5	-0.5	-0.8
EPS (controlling int.)	2,085	2,414	2,030	2,286	-2.7	-5.3

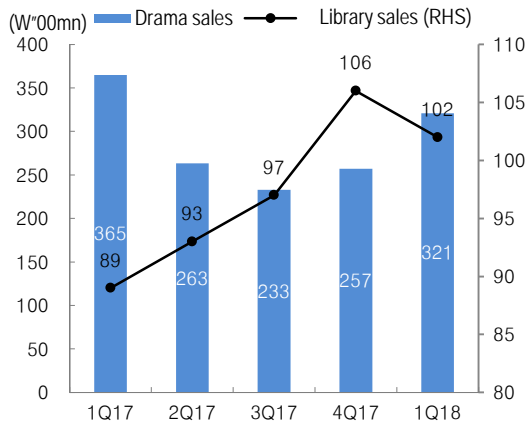
Source: Studio Dragon, Daishin Securities Research Center

Fig 1. Revenue and OP



Source: Studio Dragon, Daishin Securities Research Center

Fig 2. Drama sales



Source: Studio Dragon, Daishin Securities Research Center

Per share intrinsic value

Residual Income Model		(Wbn, W, %)									
		2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
I	NP (contr. int.) ^(Note 2)	57	64	75	84	90	104	119	137	158	181
II	Shareholders' equity (contr. int.) ^(Note 2)	425	473	528	528	590	665	748	843	946	1,065
	Estimated ROE	14.3	14.3	14.9	16.0	15.3	15.6	15.9	16.3	16.7	17.0
III	Required rate of return ^(Note 3)	5.6									
	Risk free rate of return ^(Note 4)	2.5									
	Market risk premium ^(Note 5)	4.0									
	Beta	0.77									
IV	Spread (estimated ROE – required rate of return)	8.8	8.7	9.3	10.4	9.7	10.0	10.4	10.7	11.1	11.5
V	Required income	21	24	26	29	29	33	37	42	47	53
VI	Residual income (I - V)	36	40	48	55	61	71	82	95	111	129
	Present value factor	0.96	0.91	0.86	0.82	0.78	0.73	0.70	0.66	0.62	0.59
	PV of residual income	35	37	42	45	47	52	57	63	69	76
VII	Sum of residual income	523									
VIII	PV of residual income following forecasting period	1,366									
	Terminal growth (g) ^(Note 6)	0.0%									
IX	Beginning shareholders' equity	368									
X	Fair market cap (VII+VIII+IX)	2,257									
	Total number of shares (thousands)	28,037									
XI	Per share value (W)	80,512									
	Current share price (W)	87,400									
	Potential (%)	-7.9%									

Note 1: Under the residual income model (RIM), we add the current shareholders' equity to the residual income based on the earnings forecast for the next ten years before adding the result to the residual income after the forecasting period to derive the value of shareholders' stakes. The RIM is considered less subjective than similar valuation models such as DDM, DCF, and EVA.

Note 2: The RIM reflects consolidated subsidiaries' earnings not in their entirety but only for the stake controlled by the company.

Note 3: The required rate of return (i.e., cost of equity) is the rate of return expected by the shareholders who take risks. It is derived by the capital asset price model: Cost of equity = Risk-free interest rate + Beta * Market risk premium.

Note 4: The yield on five-year government bonds was used as the proxy for the risk-free interest rate.

Note 5: Market risk premium refers to the gap between the expected return on the market portfolio and the risk-free interest rate. It has been lowered from 6-8% to 3-5% in reflection of the current low-growth environment.

Note 6: The terminal growth was assumed to be zero.

Financial statements

Income statement		(Wbn)				
	2016A	2017A	2018F	2019F	2020F	
Revenue	154	287	343	366	387	
Cost of goods sold	133	240	261	275	281	
Gross profit	22	47	82	91	106	
SG&A expenses	5	14	11	13	14	
OP	17	33	71	78	92	
OP margin	10.8	11.5	20.6	21.4	23.7	
EBITDA	39	74	134	148	174	
Non-OP	-6	-3	7	8	9	
Income from affiliates	0	0	0	0	0	
Financial revenue	1	1	7	8	9	
FX related gains	0	0	0	0	0	
Financial expense	-2	-3	-1	-1	-1	
FX related losses	1	1	0	0	0	
Others	-5	0	0	1	1	
Income before taxes	10	30	77	87	101	
Income tax expense	-2	-6	-20	-23	-26	
Income from cont. op.	8	24	57	64	75	
Income from discount. op.	0	0	0	0	0	
NP	8	24	57	64	75	
NP margin	5.3	8.3	16.6	17.5	19.3	
NP for non-contr. interest	0	0	0	0	0	
NP for contr. interest	8	24	57	64	75	
Valuation of AFS fin. assets	0	0	0	0	0	
Other compreh. income	0	0	0	0	0	
Comprehensive income	8	24	57	64	74	
Comp. income for non-contr. int.	0	0	0	0	0	
Comp. income for contr. int.	8	24	57	64	74	

Valuation metrics		(W, x, %)				
	2016A	2017A	2018F	2019F	2020F	
EPS	5,691	1,050	2,030	2,286	2,660	
PER	0.0	61.9	43.1	38.2	32.9	
BPS	61,763	13,141	15,171	16,857	18,817	
PBR	0.0	4.9	5.8	5.2	4.6	
EBITDAPS	27,127	3,271	4,767	5,293	6,221	
EV/EBITDA	0.4	22.1	16.6	14.7	12.3	
SPS	107,949	12,628	12,217	13,065	13,801	
PSR	0.0	5.1	7.2	6.7	6.3	
CFPS	24,684	3,351	4,831	5,394	6,318	
DPS	0	0	600	700	800	

Financial ratios		(W, x, %)				
	2016A	2017A	2018F	2019F	2020F	
Growth potential						
Sales growth	na	85.7	19.4	6.9	5.6	
OP growth	na	98.3	113.8	11.1	17.3	
NP growth	na	192.9	138.6	12.6	16.3	
Profitability						
ROIC	19.4	17.0	29.4	30.6	34.0	
ROA	13.7	9.4	14.6	14.7	15.8	
ROE	12.0	9.5	14.3	14.3	14.9	
Stability						
Debt ratio	77.8	24.7	19.3	17.5	15.8	
Net borrowings ratio	12.1	-49.4	-54.2	-55.5	-59.0	
Interest coverage ratio	19.5	19.0	0.0	0.0	0.0	

Source: Studio Dragon, Daishin Securities Research Center

Balance sheet		(Wbn)				
	2016A	2017A	2018F	2019F	2020F	
Current assets	81	290	339	376	428	
Cash & cash equiv.	12	51	90	122	170	
Trade & other receive.	39	55	66	71	75	
Inventories	0	1	2	2	2	
Other current assets	31	182	182	182	182	
Long-term assets	161	170	168	180	182	
Tangible assets	1	1	1	1	1	
Investments in affiliates	0	0	0	0	0	
Other long-term assets	159	169	167	179	182	
Total assets	242	459	508	555	611	
Current liabilities	84	91	82	82	83	
Payables & other liab.	23	34	35	36	36	
Borrowings	8	0	0	0	0	
Current portion of LT debts	0	10	0	0	0	
Other current liabilities	54	47	47	47	47	
Long-term liabilities	21	0	0	0	0	
Borrowings	20	0	0	0	0	
Convertible securities	0	0	0	0	0	
Other long-term liab.	2	0	0	0	0	
Total liabilities	106	91	82	83	83	
Controlling interest	136	368	425	473	528	
Capital stock	11	14	14	14	14	
Capital surplus	115	320	320	320	320	
Retained earnings	8	32	89	136	191	
Other capital changes	2	3	3	3	3	
Non-controlling interest	0	0	0	0	0	
Total shareholder's equity	136	368	425	473	528	
Net borrowings	16	-182	-231	-262	-311	

Cash flow statement		(Wbn)				
	2016A	2017A	2018F	2019F	2020F	
Operating cash flows	-12	-7	47	67	90	
NP	8	24	57	64	75	
Non-cash items	27	52	79	87	103	
Depreciation	22	41	63	70	83	
FX gains	0	1	0	0	0	
Equity method gain	0	0	0	0	0	
Others	5	10	15	17	20	
Chg in assets & liab.	-46	-73	-76	-70	-70	
Other cash flows	-2	-10	-13	-14	-17	
Investing cash flow	-70	-141	-62	-81	-85	
Investment assets	0	-1	0	0	0	
Tangible assets	-1	0	0	0	0	
Others	-68	-140	-62	-81	-85	
Financing cash flows	93	188	-12	-18	-21	
Short-term borrowings	7	-8	0	0	0	
Bonds payable	20	10	0	0	0	
Long-term borrowings	0	0	0	0	0	
Rights offering	56	208	0	0	0	
Cash dividends	0	0	0	-17	-20	
Others	10	-22	-12	-2	-2	
Net chg in cash	12	40	90	32	49	
Beginning cash balance	0	12	0	90	122	
Ending cash balance	12	51	90	122	170	
NOPLAT	13	26	52	58	68	
FCF	34	67	53	47	65	

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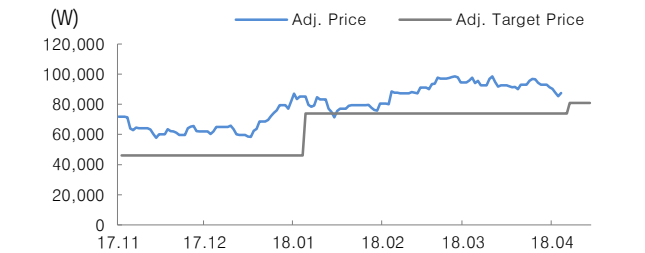
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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Date	18.04.30	18.01.28	17.11.25
Rating	Marketperform	Marketperform	Buy
Target price	81,000	74,000	46,000
Diff (avr. %)		19.40	44.64
Diff (max/min, %)		(3.51)	25.65

Date	
Rating	
Target price	
Diff (avr. %)	
Diff (max/min, %)	

Date	
Rating	
Target price	
Diff (avr. %)	
Diff (max/min, %)	

Date	
Rating	
Target price	
Diff (avr. %)	
Diff (max/min, %)	

Investment rating breakdown and framework (Apr 25, 2018)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	82.7%	15.8%	1.0%

Sector ratings breakdown

- Overweight: industry indicators are expected to outperform the market over the next six months.
- Neutral: industry indicators are expected to be in line with the market over the next six months.
- Underweight: industry indicators are expected to underperform the market over the next six months.

Company ratings breakdown

- Buy: the stock is expected to outperform the market by at least 10%p over the next six months.
- Marketperform: the stock is expected to either outperform or underperform the market by less than 10%p over the next six months.
- Underperform: the stock is expected to underperform the market by at least 10%p over the next six months.