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1Q18 earnings missed consensus

Studio Dragon achieved 1Q18 OR of KRW79.9bn (up 6% YoY) and OP of KRW10.7bn (down 23.7% YoY), with OP falling 26.5% short of consensus. Production revenue surged 54.5% YoY, but copyright sales decreased 12% YoY, contributing to tepid earnings. Production revenue grew 54.5% YoY, aided by the number of drama productions increasing from five in 1Q17 to eight in 1Q18 and an increase in contents supply to a captive client and consequent sales growth (sales to a captive client up 64% YoY). Despite an overseas achievement (e.g., KRW10bn in revenues from “A Korean Odyssey” copyright sales to Netflix; KRW9bn booked in 1Q18 earnings), a dent in VOD revenues and sluggish copyright sales, hindered by the #Me-Too revelations, sent total distribution sales lower by 12% YoY. However, we believe that the #Me-Too revelations should have a fleeting impact on contents sales, while the company’s fundamentals remain robust. The COGS-to-OR ratio kept rising in every quarter through 2017, but slid 6.7p% YoY to 82.9% in 1Q18, raising the prospect of COGS-to-OR ratio stabilizing ahead.

Resumption of contents sales to China to sway share price

We project sluggish contents sales to recover in 2Q18, with 2Q18 OR and OP looking to normalize to KRW83.6bn (up 4.6% QoQ, up 34.6% YoY) and KRW12.4bn (up 16.7% QoQ, up 39.9% YoY), respectively. However, the share price seems highly likely to react sensitively to news flow regarding contents sales rather than 2Q18 earnings. “Mr. Sunshine,” one of the highly-anticipated projects in 2018, is due to go on air in Jul, while its copyright sales overseas are highly anticipated. We expect OR growth to materialize from 2H18, aided by the resumption of contents sales to China and a rise in the number of clients for contents sales, as witnessed by Netflix having begun original content production.

Buy maintain

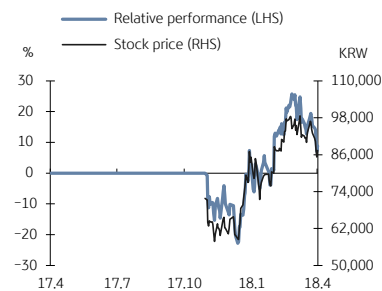
Target Price (lowered)	KRW110,000
Upside/Downside	25.9%
Current price (Apr 27)	KRW87,400
Consensus Target Price	KRW110,667
Market cap	USD2.3bn

Trading Data	
Free float	23.9%
Avg T/O Val (3M, KRWbn)	16.5
Foreign ownership	1.0%
Major shareholders	CJ E&M Corporation and 3 others 75.7%

Performance (%)				
	1M	3M	6M	12M
Absolute	-10.5	2.6	0.0	0.0
Relative	-13.2	5.7	0.0	0.0

Forecast earnings & valuation

FY-end	2017A	2018E	2019E	2020E
OR (KRWbn)	287	374	468	540
OP (KRWbn)	33	64	90	109
NP to parent (KRWbn)	24	49	71	86
EPS (KRW)	1,050	1,758	2,529	3,084
EPS Growth (%)	84.5	67.4	43.9	21.9
PER (x)	61.9	49.7	34.6	28.3
EV/EBITDA (x)	22.1	35.8	24.4	19.3
PBR (x)	4.9	5.9	5.0	4.3
ROE (%)	9.5	12.5	15.7	16.3
Div. Yield (%)	NA	0.0	0.0	0.0

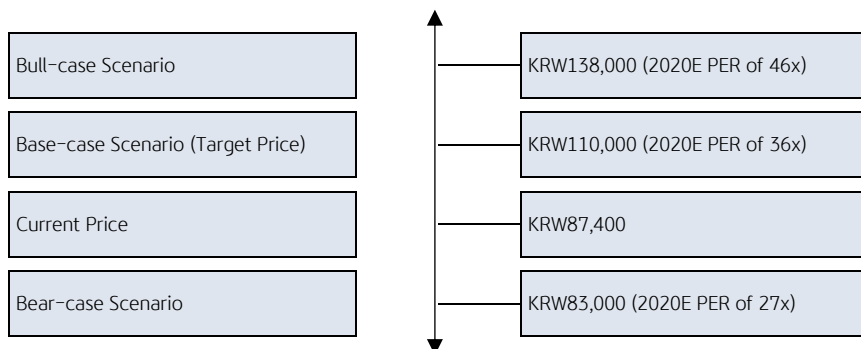


Source: Studio Dragon, KB Securities estimates

**Keep Buy and cut target price by
4.3% to KRW110,000**

In reflection of our downward revisions to earnings projections, we cut our target price to KRW110,000, while we keep Buy on Studio Dragon. The target price of KRW110,000 is derived by applying a 2020 EPS projection and an average PER of 36x of peers.

Investment opinion and risks



Base-case Scenario: Catalysts

- 1) Drama production volume rises to 40 by 2020
- 2) Contents sales to China resume in 2018

Bull-case Scenario: Upside risks

- 1) Expanded content sales to Netflix
- 2) Expanded cooperation with global companies

Bear-case Scenario: Downside risks

- 1) Delayed content sales to China
- 2) Decreased demand for Korean Wave contents

Adjusted earnings estimates

(KRWbn, %)	Before		After		Change	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	375.5	463.0	373.6	468.2	-0.5	1.1
OP	67.2	93.8	63.5	90.3	-5.4	-3.7
NP to parent	53.6	74.5	49.3	70.9	-8.0	-4.8

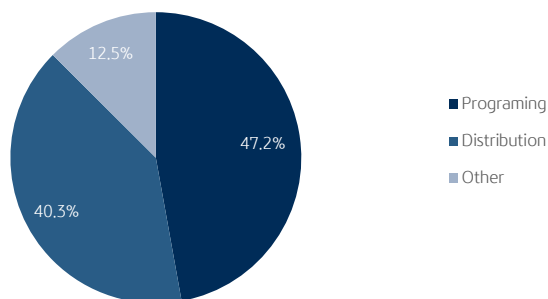
Source: KB Securities estimates

Difference vs. Consensus

(KRWbn, %)	KB Securities		Consensus		Contrast	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	373.6	468.2	383.6	488.0	-2.6	-4.1
OP	63.5	90.3	69.9	104.3	-9.1	-13.4
NP to parent	49.3	70.9	52.9	81.9	-6.7	-13.5

Source: FnGuide, KB Securities estimates

OR composition (%): 2018E basis



Source: Company data, KB Securities estimates

Valuation and target price calculation

- 1) Valuation method:
PER Valuation
- 2) Target price calculation:
2020E EPS of KRW3,084 x multiple of 36x
- 3) Upside ~ downside of target price:
KRW138,000 ~ KRW83,000
- 4) Valuation upon arriving at target price:
PER of 36x

Earnings sensitivity analysis

(%)	EPS change	
	2018E	2019E
1) 1%p rise in interest rate	+2.1	+2.1
2) 1% rise in FX rate	+0.4	+0.4

PEER group comparison

(KRWbn, X, %)	Market cap.	PER		PBR		EV/EBITDA		ROE		Dividend Yield	
		2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E
Jcontentree	857	28.4	22.2	4.9	4.0	13.2	10.9	19.5	20.8	n/a	2.0
Netflix	144,783	95.2	61.6	28.4	20.3	67.9	44.2	26.2	28.4	0.0	0.0
Zhejiang Huace Film & TV	3,237	24.4	19.1	2.5	2.2	20.2	15.3	10.5	12.4	0.5	0.6
Beijing Hualu Baina	1,430	14.9	12.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: Bloomberg consensus, KB Securities

Table 1. Studio Dragon's 1Q18 consolidated earnings review

(KRWon, %, %p)	1Q18P	4Q17	QoQ	1Q17	YoY	KB estimates	Diff.	Consensus	Diff.
OR	79.9	71.9	11.1	75.3	6.0	90.7	(11.9)	86.8	(7.9)
OP	10.7	3.5	207.1	14.0	(23.7)	16.3	(34.5)	14.5	(26.5)
<i>OP margin</i>	<i>13.3</i>	<i>4.8</i>	<i>8.5</i>	<i>18.5</i>	<i>(5.2)</i>	<i>18.0</i>	<i>(4.6)</i>	<i>16.7</i>	<i>(3.4)</i>
NP to parent	7.9	2.0	293.5	13.4	(41.3)	12.9	(39.3)	11.7	(32.9)
<i>NP margin</i>	<i>9.8</i>	<i>2.8</i>	<i>7.1</i>	<i>17.8</i>	<i>(7.9)</i>	<i>14.3</i>	<i>(4.4)</i>	<i>13.5</i>	<i>(3.7)</i>

Source: FnGuide, KB Securities estimates

Table 2. Studio Dragon's consolidated earnings trend and estimates

(KRWbn)	1Q17	2Q17	3Q17	4Q17	1Q18P	2Q18E	3Q18E	4Q18E	2017	2018E	2019E	2020E
OR	75.3	62.1	77.5	71.9	79.9	83.6	102.8	107.4	286.8	373.6	468.2	539.6
(QoQ %)	0.0	(17.6)	24.8	(7.3)	11.1	4.6	23.0	4.5	-	-	-	-
(YoY %)	-	-	-	-	6.0	34.6	32.6	49.4	46.7	30.3	25.3	15.2
Programming	26.3	24.1	41.8	39.0	40.7	39.2	47.2	49.1	131.2	176.2	217.9	254.7
Distribution	36.5	26.3	23.3	25.7	32.1	31.6	41.9	45.0	111.8	150.6	198.0	229.9
Others	12.5	11.6	12.4	7.2	7.1	12.8	13.7	13.3	43.7	46.8	52.3	55.0
OP	14.0	8.9	6.7	3.5	10.7	12.4	20.1	20.3	33.0	63.5	90.3	109.4
(QoQ %)	-	(36.4)	(25.2)	(47.8)	207.1	16.7	61.6	1.1	-	-	-	-
(YoY %)	-	-	-	-	(23.7)	39.9	202.3	485.9	55.6	92.6	42.1	21.2
<i>OP margin (%)</i>	<i>18.5</i>	<i>14.3</i>	<i>8.6</i>	<i>4.8</i>	<i>13.3</i>	<i>14.9</i>	<i>19.6</i>	<i>18.9</i>	<i>11.5</i>	<i>17.0</i>	<i>19.3</i>	<i>20.3</i>
NP to parent	13.4	2.8	5.7	2.0	7.9	9.9	15.7	15.9	23.8	49.3	70.9	86.5
(QoQ %)	-	(79.1)	102.2	(64.7)	293.5	25.6	58.7	1.4	-	-	-	-
(YoY %)	-	-	-	-	(41.3)	252.5	176.7	695.8	-	106.7	43.9	21.9
<i>NP margin (%)</i>	<i>17.8</i>	<i>4.5</i>	<i>7.3</i>	<i>2.8</i>	<i>9.8</i>	<i>11.8</i>	<i>15.3</i>	<i>14.8</i>	<i>8.3</i>	<i>13.2</i>	<i>15.1</i>	<i>16.0</i>

Source: Company data, KB Securities estimates

Table 3. Comparison of adjusted earnings estimates

(KRWbn, %, %p)	2018E					2019E				
	Changed	Previous	Diff.	Cons.	Diff.	Changed	Previous	Diff.	Cons.	Diff.
OR	373.6	375.5	(0.5)	383.6	(2.6)	468.2	463.0	1.1	488.0	(4.1)
OP	63.5	67.2	(5.4)	69.9	(9.1)	90.3	93.8	(3.7)	104.3	(13.4)
<i>OP margin</i>	<i>17.0</i>	<i>17.9</i>	<i>(0.9)</i>	<i>18.2</i>	<i>(1.2)</i>	<i>19.3</i>	<i>20.2</i>	<i>(1.0)</i>	<i>21.4</i>	<i>(2.1)</i>
NP to parent	49.3	53.6	(8.0)	52.9	(6.7)	70.9	74.5	(4.8)	81.9	(13.5)
<i>NP margin</i>	<i>13.2</i>	<i>14.3</i>	<i>(1.1)</i>	<i>13.8</i>	<i>(0.6)</i>	<i>15.1</i>	<i>16.1</i>	<i>(0.9)</i>	<i>16.8</i>	<i>(1.6)</i>

Source: FnGuide, KB Securities estimates

Table 4. Studio Dragon's PER valuation

(KRWbn, %, '000, KRW)		Note
2020E NP to parent	86.5	
Target PER	36.0	2018E avg of Jcontentree, Zhejiang Huace, Huala Baina
Fair market cap	3,113	
# of Total shares	28,037	Fully diluted basis
Target stock price	110,000	
Current price	87,400	
Upside	25.9%	

Source: Company data, Bloomberg, KB Securities estimates

Table 5. Studio Dragon's 2018 contents line-up

	Date	Title	Channel	Trilogy
1Q18	2018-01-08	My First Love	OCN	10
	2018-01-24	Mother	tvN	16
	2018-01-29	Cross	tvN	16
	2018-02-24	Children of a Lesser God	OCN	16
	2018-03-03	Live	tvN	18
	2018-03-05	That Man O-su	OCN	10
	2018-03-21	My Uncle	tvN	16
	2018-03-26	To You Who Forgot Poetry	tvN	16
2Q18	2018-04-28	Mistress	OCN	12
	2018-05-12	Lawless Lawyer	tvN	16
	2018-05-21	About Time	tvN	16
	2018-06-06	Why Secretary Kim	tvN	16
	2018-06-16	Life on Mars	OCN	16
2H18	2018-07	Mr. Sunshine	tvN	24
	2018-07	Let's Eat3	tvN	Undefined
	2018-08	A grass that fell from the sky	tvN	Undefined
	2018-08	Voice 2	OCN	Undefined
	2018-11	Memories of Alhambra Palace	tvN	Undefined
	Undefined	100 Million Stars from the Sky	tvN	Undefined

Note: Shaded parts are highly-anticipated releases in 2018

Source: Company data, KB Securities

Profit & Loss					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	154	287	374	468	540
Cost of sales	133	240	294	359	408
Gross profit	22	47	80	109	131
SG&A expenses	5	14	16	19	22
Operating profit	17	33	64	90	109
EBITDA	39	74	64	90	109
Non-operating accounts	-6	-3	3	4	6
Interest income	0	1	4	5	6
Interest expenses	1	2	1	0	0
Profit on equity method	0	0	0	0	0
Net other non-operating income	-5	0	-1	0	0
Profit before tax	11	30	66	95	115
Income tax expense	2	6	17	24	29
Net profit	8	24	49	71	86
NP to parent	8	24	49	71	86
Adj. net profit	8	24	49	71	86

Operating Statistics & Ratios					
(%)	2016A	2017A	2018E	2019E	2020E
OR growth	NA	85.7	30.3	25.3	15.3
OP growth	NA	98.3	92.6	42.1	21.2
EBITDA growth	NA	91.4	-14.5	42.1	21.2
NP growth of parent	NA	193.0	106.7	43.9	21.9
GP margin	14.0	16.4	21.3	23.4	24.4
OP margin	10.8	11.5	17.0	19.3	20.3
EBITDA margin	25.1	25.9	17.0	19.3	20.3
EBT margin	6.8	10.6	17.7	20.2	21.4
NP margin	5.3	8.3	13.2	15.2	16.0

Cash Flow					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
Cash flow from operating activities	-12	-7	56	78	95
Net profit	8	24	49	71	86
Depreciation & amortization	22	41	0	0	0
Other non-cash adjustments	5	5	17	24	29
Investments in working capital	-46	-73	6	7	9
Decrease(Increase) in Receivables	0	-14	-2	-2	-2
Decrease(Increase) in Inventories	0	-2	0	0	0
Increase(Decrease) in Payables	11	9	1	1	1
Other operating cash flow	-2	20	-17	-24	-29
Cash flow from investing activities	-70	-141	-13	-14	-14
Capital expenditure	-1	0	-1	-1	-1
Investments in intangibles	0	0	-1	-1	-1
Changes in investment assets	0	-1	0	0	0
Other investment cash flow	-68	0	-5	-5	-6
Cash flow from financing activities	93	188	1	1	2
Proceeds from (repayments of) debt	27	-18	1	1	2
Changes in equity	56	208	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flow	10	-2	0	0	0
Other cash flow	0	0	0	0	0
Increase/decrease in cash	12	40	44	66	82
Cash and cash equivalents at FYE	12	51	44	110	192
Free cash flow	-14	-7	54	77	94
Net cash flow	0	199	-3	71	87
Net cash (net debt)	-16	182	179	250	337

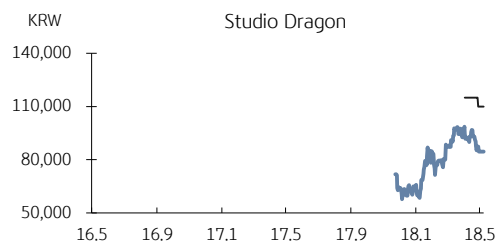
Source: Studio Dragon, KB Securities estimates

Statement of financial position					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Total assets	242	459	469	553	653
Current assets	81	290	292	368	461
Cash and cash equivalents	12	51	44	110	192
Current financial assets	0	141	147	153	159
Trade receivables	37	55	57	59	62
Inventories	0	1	1	1	1
Other current assets	33	41	43	45	47
Non-current assets	161	170	177	184	193
Investment assets	2	4	4	4	4
Property, plant and equipment	1	1	2	3	5
Intangible assets	124	128	129	130	131
Other non-current assets	33	36	40	45	51
Total liabilities	106	91	102	115	130
Current liabilities	84	91	102	115	129
Trade payables	6	6	7	8	9
Short-term financial liabilities	8	10	11	13	14
Other current liabilities	71	75	84	95	106
Non-current liabilities	21	0	0	0	0
Non-current financial liabilities	20	0	0	0	0
Other non-current liabilities	0	0	0	0	0
Total equity	136	368	418	489	575
Issued capital	11	14	14	14	14
Share premium	115	320	320	320	320
Other equity interest	2	3	3	3	3
Accumulated other comprehensive income	0	0	0	0	0
Retained earnings	8	32	81	152	239
Equity attributable to owners of parent	136	368	418	489	575
Non-controlling Interests	0	0	0	0	0

Main Ratio					
(X, %, KRW)	2016A	2017A	2018E	2019E	2020E
Multiples					
PER	NA	61.9	49.7	34.6	28.3
PBR	NA	4.9	5.9	5.0	4.3
PSR	NA	5.1	6.6	5.2	4.5
EV/EBITDA	0.4	22.1	35.8	24.4	19.3
EV/EBIT	1.0	49.7	35.8	24.4	19.3
Dividend yield, ordinary (%)	NA	NA	0.0	0.0	0.0
EPS	569	1,050	1,758	2,529	3,084
BPS	6,176	13,141	14,900	17,429	20,513
SPS	10,795	12,628	13,325	16,700	19,246
DPS (Annual, Ordnry.)	0	0	0	0	0
Cash dividends payout ratio (%)	0.0	0.0	0.0	0.0	0.0
Operating performance					
ROE	6.0	9.5	12.5	15.7	16.3
ROA	3.4	6.8	10.6	13.9	14.3
ROIC	16.9	15.6	26.1	37.1	45.1
Financial structure (%)					
Total liab./equity	77.8	24.7	24.5	23.6	22.5
Net debt/equity	12.1	Net Cash	Net Cash	Net Cash	Net Cash
Current Ratio	1.0	3.2	2.9	3.2	3.6
Interest coverage (x)	19.5	19.0	95.3	220.6	237.7
Activity ratios					
Asset turnover (x)	0.0	0.8	0.8	0.9	0.9
Receivables turnover (x)	0.0	6.2	6.7	8.0	8.9
Inventory turnover (x)	0.0	0.0	288.6	361.7	416.8

Disclosures

Rating and Target Price Changes (Share price —, Target Price —)



Studio Dragon (253450)

Date	Rating	Target Price (KRW)	Differential (%)	
			Avg.	Max/Min
18-04-03	Buy	115,000	-20.05	-15.74
18-04-29	Buy	110,000		

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Proportion of investment rating (as of March 31, 2018)

Buy	Hold	Sell
72.9	27.1	-

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

Classification and Standards for Investment Rating

Investment Rating for Company

(based on estimation of six-month absolute returns)

Buy: +15% or beyond	Hold: Between 15% and -15%	Sell: -15% or beyond
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Note: KB Securities's classification of investment ratings has shifted from four stages (Strong BUY, BUY, Marketperform, Underperform) to three stages (Buy, Hold, Sell) based on Korean reports since February 23, 2017.

Investment Rating for Industry

(based on estimation of six-month absolute returns)

Positive:	Neutral:	Negative:
To outperform market	To match market performance	To underperform market

Notes: The industry rating system of KB Securities has shifted from (Overweight, Neutral, Underweight) to (Positive, Neutral, Negative) as of Jun 28, 2017

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