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Expectations mounting over resumption of contents sales to China

Contents sales to China have been halted following the Korean government's decision to deploy THAAD batteries, but the likelihood of contents sales resuming is getting stronger, which is shedding light on Studio Dragon as the biggest beneficiary. Indeed, Korean artists have started to reappear on Chinese online broadcast programs or music charts, while sales contracts for entertainment program copyrights have ensued. According to recent media reports, a booth for Korean contents will open for the first time in two years at the Shanghai Television Festival slated for Jun, 2018. Three terrestrial broadcasters, general program providers, and CJ E&M are known to be participating in the event, which heralds the resumption of sales contracts for Korean contents to Chinese platform providers.

Content distribution sales growth to accelerate driven by tentpole line-ups in 2H18

In 2H18, Studio Dragon's earnings are set to expand driven by its tentpole programming and original content production for Netflix. "Mr. Sunshine" (written by Kim Eun-sook; starring Lee Byung-hun/Kim Tae-ri), the most anticipated drama in 2018, is scheduled to be aired in Jul, 2018, with its production costs estimated at around KRW40bn. It seems the series will have no trouble breaking even given the anticipated high demand from overseas markets and global OTT service providers. "Guardian: The Lonely and Great God," which aired in 2017, achieved a GP margin of around 50%. Another tent-pole series, "Memories of the Alhambra" (written by Song Jae-jeong, starring Hyun Bin and Park Shin-hye), is slated to air in 4Q18. It seems highly likely that licensing deals to China will materialize within 2H18. The company is also expected to produce two original contents for Netflix. As a result, Studio Dragon is expected to display a "low 1H, high 2H" earnings pattern.

Buy maintain

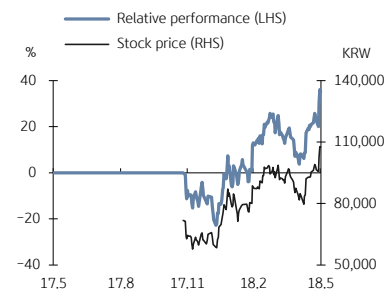
Target Price (raised)	KRW130,000
Upside/Downside	20.7%
Current price (May 31)	KRW107,700
Consensus Target Price	KRW112,615
Market cap	USD2.8bn

Trading Data	
Free float	23.9%
Avg T/O Val (3M, KRWbn)	15.6
Foreign ownership	1.5%
Major shareholders	CJ E&M Corporation and 3 others 75.7%

Performance (%)	1M	3M	6M	12M
Absolute	27.3	22.8	67.0	0.0
Relative	26.8	19.6	46.4	0.0

Forecast earnings & valuation

FY-end	2017A	2018E	2019E	2020E
OR (KRWbn)	287	373	478	552
OP (KRWbn)	33	67	102	128
NP to parent (KRWbn)	24	52	79	101
EPS (KRW)	1,050	1,858	2,835	3,593
EPS Growth (%)	84.5	77.0	52.6	26.7
PER (x)	61.9	58.0	38.0	30.0
EV/EBITDA (x)	22.1	25.8	21.7	18.3
PBR (x)	4.9	7.2	6.0	5.0
ROE (%)	9.5	13.2	17.3	18.3
Div. Yield (%)	NA	0.0	0.0	0.0

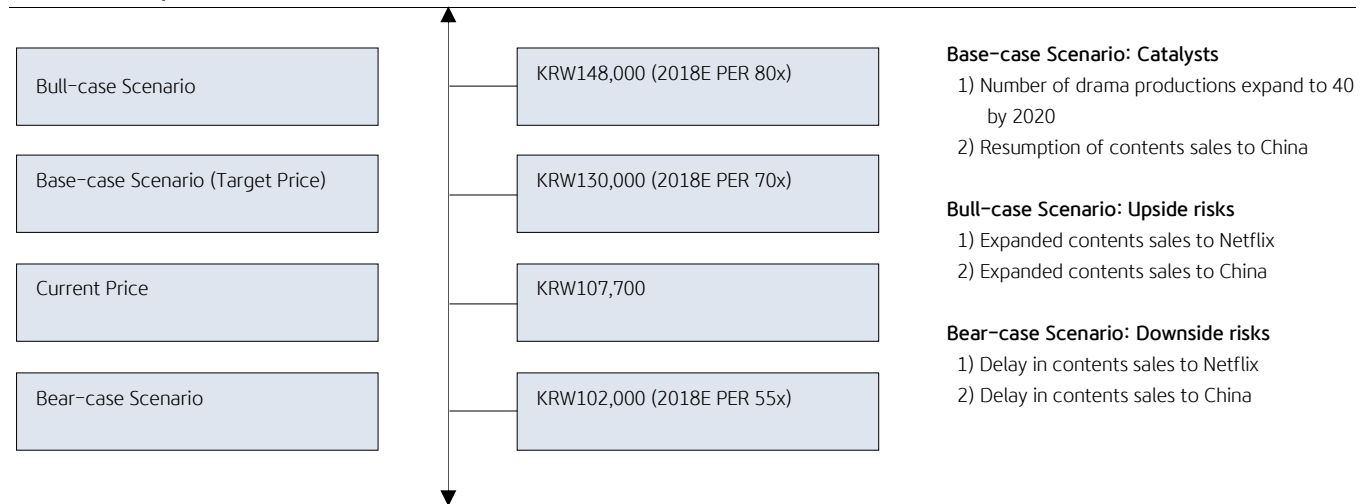


Source: Studio Dragon, KB Securities estimates

**Maintain Buy; Target price raised
18.2% to KRW130,000**

We maintain Buy on Studio Dragon, while raising the target price 18.2% to KRW130,000. The target price was derived by applying the peer group's average PER of 36x to the company's 2020 EPS. The target price was raised due to upward revisions to our 2018-2020 earnings estimates. Studio Dragon shares have been performing well in 2018, climbing 65.7% YTD. The pending tent-pole series scheduled to air from 2H18 and full-fledged contents expansion should provide plenty of additional upside. Supply/demand dynamics related to the company's shares are likely to improve as the company is scheduled to be added to the KOSDAQ 150 on Jun 15.

Investment opinion and risks



Adjusted earnings estimates

(KRWbn, %)	Previous		Adjusted		Change	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	374	468	373	478	-0.3	2.2
OP	64	90	67	102	5.9	12.7
NP (to parent)	49	71	52	79	5.7	12.1

Source: KB Securities estimates

Difference vs. Consensus

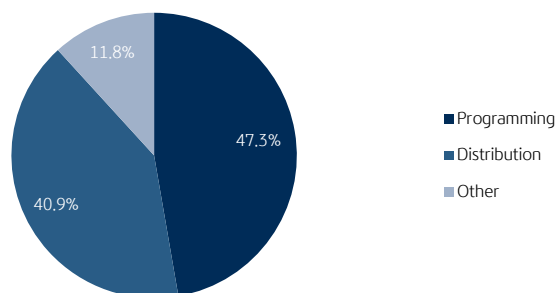
(KRWbn, %)	KB estimate		Consensus		Contrast	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	373	478	376	484	-0.9	-1.1
OP	67	102	67	101	0.5	0.2
NP (to parent)	52	79	52	79	0.6	0.0

Source: WISEfn, KB Securities estimates

Valuation and target price calculation

- 1) Valuation Method:
PER valuation
- 2) Per-share value:
2018E BPS of KRW3,593 X PER 36x
- 3) Upside ~ downside of target price:
KRW148,000 ~ KRW102,000
- 4) Valuation upon arriving at target price:
PER 70x

OR breakdown (%): 2018 basis



Source: Company data, KB Securities

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	881	29.6	22.4	4.8	3.9	12.2	10.2	17.7	20.0	n/a	1.3
Netflix	164,408	106.6	68.7	31.6	22.4	74.2	49.3	26.4	28.5	0.0	0.0
Zhejiang Huace Film & TV	3,023	23.2	18.1	2.4	2.1	19.2	14.5	10.5	12.4	0.5	0.5
Beijing HualuBaina Film & TV	1,206	12.6	10.3	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 consolidated earnings trend and estimates

(KRWbn)	1Q17	2Q17	3Q17	4Q17	1Q18E	2Q18E	3Q18E	4Q18E	2017	2018E	2019E	2020E
OR	75.3	62.1	77.5	71.9	79.9	77.3	106.8	108.7	286.8	372.7	478.4	551.7
(QoQ %)	0.0	(17.6)	24.8	(7.3)	11.1	(3.2)	38.2	1.8	-	-	-	-
(YoY %)	-	-	-	-	6.0	24.5	37.8	51.2	46.7	29.9	28.4	15.3
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	27.7	46.6	46.3	111.8	152.6	211.2	245.3
Others	12.5	11.6	12.4	7.2	7.1	10.5	13.1	13.3	43.7	43.9	49.2	51.7
OP	14.0	8.9	6.7	3.5	10.7	10.0	24.0	22.6	33.0	67.3	101.7	128.4
(QoQ %)	-	(36.4)	(25.2)	(47.8)	207.1	(6.4)	140.5	(5.6)	-	-	-	-
(YoY %)	-	-	-	-	(23.7)	12.2	260.8	552.4	55.6	104.0	51.2	26.3
<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>12.9</i>	<i>22.5</i>	<i>20.8</i>	<i>11.5</i>	<i>18.1</i>	<i>21.3</i>	<i>23.3</i>
NP to parent	13.4	2.8	5.7	2.0	7.9	8.0	18.6	17.6	23.8	52.1	79.5	100.7
(QoQ %)	-	(79.1)	102.2	(64.7)	293.5	2.1	131.6	(5.2)	-	-	-	-
(YoY %)	-	-	-	-	(41.3)	186.6	228.3	782.6	-	118.5	52.6	26.7
<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>10.4</i>	<i>17.4</i>	<i>16.2</i>	<i>8.3</i>	<i>14.0</i>	<i>16.6</i>	<i>18.3</i>

Source: Company data, KB Securities estimates

Table 2. Studio Dragon's 2018 contents line-up

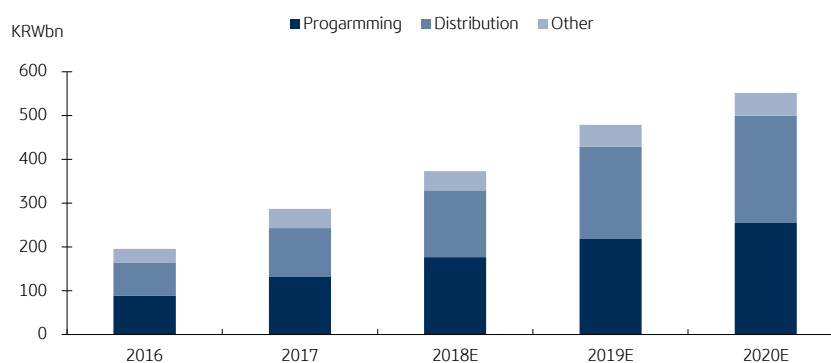
Time of airing	Date	Title	Channel	Trilogy
1Q18	2018-01-08	My First Love	OCN	10
	2018-01-24	Mother	tvN	16
	2018-01-29	Cross	tvN	16
	2018-02-24	Children of a Lesser God	OCN	16
	2018-03-03	Live	tvN	18
	2018-03-05	That Man O-su	OCN	10
	2018-03-21	My Uncle	tvN	16
	2018-03-26	To You Who Forgot Poetry	tvN	16
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
	2018-06-09	Life on Mars	OCN	16
2H18	2018-07-07	Mr. Sunshine	tvN	24
	2018-07	Let's Eat (Season 3)	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 form the Sky	tvN	Undefined

Source: Company data, KB Securities

Note: Shaded areas are highly-anticipated releases in 2018

Distribution sales growth to accelerate on contents expansion

Fig 1. Sales trend by business segment



Source: Company data, KB Securities estimates

Profit & Loss					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	154	287	373	478	552
Cost of sales	133	240	292	360	405
Gross profit	22	47	81	118	147
SG&A expenses	5	14	14	16	19
Operating profit	17	33	67	102	128
EBITDA	39	74	107	122	140
Non-operating accounts	-6	-3	3	4	6
Interest income	0	1	4	5	6
Interest expenses	1	2	0	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	70	106	134
Income tax expense	2	6	18	27	34
Net profit	8	24	52	79	101
NP to parent	8	24	52	79	101
Adj. net profit	8	24	52	79	101

Operating Statistics & Ratios					
(%)	2016A	2017A	2018E	2019E	2020E
OR growth	NA	85.7	29.9	28.4	15.3
OP growth	NA	98.3	104.0	51.2	26.3
EBITDA growth	NA	91.4	43.9	14.4	14.1
NP growth of parent	NA	193.0	118.5	52.6	26.7
GP margin	14.0	16.4	21.7	24.7	26.7
OP margin	10.8	11.5	18.1	21.3	23.3
EBITDA margin	25.1	25.9	28.7	25.6	25.3
EBT margin	6.8	10.6	18.7	22.2	24.3
NP margin	5.3	8.3	14.0	16.6	18.3

Cash Flow					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
Cash flow from operating activities	-12	-7	85	107	120
Net profit	8	24	52	79	101
Depreciation & amortization	22	41	40	21	11
Other non-cash adjustments	5	5	18	27	34
Investments in working capital	-46	-73	-7	7	8
Decrease(Increase) in Receivables	0	-14	5	-2	-2
Decrease(Increase) in Inventories	0	-2	0	0	0
Increase(Decrease) in Payables	11	9	-5	0	0
Other operating cash flow	-2	20	-17	-27	-34
Cash flow from investing activities	-70	-141	-26	-14	-15
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	-3	-5	-6
Cash flow from financing activities	93	188	-10	0	0
Proceeds from (repayments of) debt	27	-18	0	0	0
Changes in equity	56	208	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flow	10	-2	-10	0	0
Other cash flow	0	0	0	0	0
Increase/decrease in cash	12	40	49	93	105
Cash and cash equivalents at FYE	12	51	100	193	298
Free cash flow	-14	-7	84	106	119
Net cash flow	0	199	80	99	112
Net cash (net debt)	-16	182	262	361	473

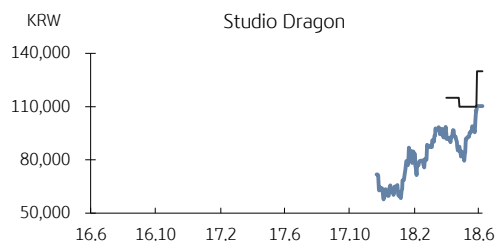
Statement of financial position					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Total assets	242	459	508	598	711
Current assets	81	290	356	459	574
Cash and cash equivalents	12	51	100	193	298
Current financial assets	0	141	161	168	175
Trade receivables	37	55	50	52	54
Inventories	0	1	1	1	1
Other current assets	33	41	42	44	46
Non-current assets	161	170	152	139	137
Investment assets	2	4	5	5	5
Property, plant and equipment	1	1	2	3	4
Intangible assets	124	128	102	82	73
Other non-current assets	33	36	43	48	54
Total liabilities	106	91	87	98	110
Current liabilities	84	91	87	98	110
Trade payables	6	6	3	3	4
Short-term financial liabilities	8	10	0	0	0
Other current liabilities	71	75	84	94	106
Non-current liabilities	21	0	1	1	1
Non-current financial liabilities	20	0	0	0	0
Other non-current liabilities	0	0	0	0	0
Total equity	136	368	421	500	601
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	84	164	264
Equity attributable to owners of parent	136	368	421	500	601
Non-controlling Interests	0	0	0	0	0

Main Ratio					
(X, %, KRW)	2016A	2017A	2018E	2019E	2020E
Multiples					
PER	NA	61.9	58.0	58.0	30.0
PBR	NA	4.9	7.2	6.0	5.0
PSR	NA	5.1	8.1	6.3	5.5
EV/EBITDA	0.4	22.1	25.8	21.7	18.3
EV/EBIT	1.0	49.7	41.0	26.1	19.8
Dividend yield, ordinary (%)	NA	NA	0.0	0.0	0.0
EPS	569	1,050	1,858	2,835	3,593
BPS	6,176	13,141	15,006	17,841	21,434
SPS	10,795	12,628	13,291	17,061	19,679
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	13.2	17.3	18.3
ROA	3.4	6.8	10.8	14.4	15.4
ROIC	16.9	15.6	30.0	53.3	75.5
Financial structure (%)					
Total liab./equity	77.8	24.7	20.7	19.6	18.4
Net debt/equity	12.1	Net Cash	Net Cash	Net Cash	Net Cash
Current Ratio	1.0	3.2	4.1	4.7	5.2
Interest coverage (x)	19.5	19.0	210.9	248.6	279.0
Activity ratios					
Asset turnover (x)	0.0	0.8	0.8	0.9	0.8
Receivables turnover (x)	0.0	6.2	7.1	9.4	10.4
Inventory turnover (x)	0.0	0.0	270.3	327.1	377.2

Source: Studio Dragon, KB Securities estimates

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	-15.81	-2.00
18-06-01	Buy	130,000		

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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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