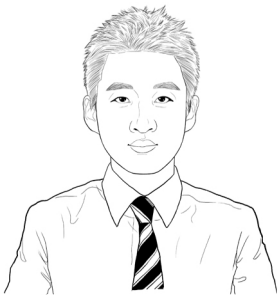


2018. 7. 13

# Company Update



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## AT A GLANCE

SELL HOLD **BUY**

**Target price** KRW140,000 (16.9%)

**Current price** KRW119,800

Market cap KRW3.4t/USD3.0b  
Shares (float) 28,037,240 (23.9%)  
52-week high/low KRW119,800/KRW57,800  
Avg daily trading value (60-day) KRW18.9b/USD16.8m

## ONE-YEAR PERFORMANCE

	1M	6M	12M
Studio Dragon (%)	9.0	74.9	n/a
Vs Kosdaq (%pts)	16.4	86.4	n/a

## KEY CHANGES

(KRW)	New	Old	Diff
Recommend.	BUY	BUY	
Target price	140,000	100,000	40.0%
2018E EPS	1,441	1,582	-8.9%
2019E EPS	2,391	2,406	-0.6%

## SAMSUNG vs THE STREET

No of estimates	11
Target price	126,182
Recommendation	3.9

BUY\*\*\*: 5 / BUY: 4 / HOLD: 3 / SELL: 2 / SELL\*\*\*: 1

## Studio Dragon (253450)

### Earnings to follow production costs

- The first and second episode of Studio Dragon's tentpole drama Mr. Sunshine got a viewership rating of 8.9% and 9.7%, respectively, the highest ever for a tvN drama.
- The company's 2Q earnings will likely fall just short of consensus, but we believe that its progress in enhancing content quality has been outstanding.
- We hike our target price to KRW140,000. With the global OTT market still in its infancy, Studio Dragon's production costs should rise over the mid- to long term.

### WHAT'S THE STORY?

**Mr. Sunshine off to good start:** The first and second episode of Mr. Sunshine aired on July 7 and 8, respectively, logging viewership ratings of 8.9% and 9.7%, the highest ever for a tvN drama (the previous highest figures went to Goblin—6.3% for the first episode and 7.9% for the second). While we should continue monitoring the trend, the initial ratings for Studio Dragon's second tentpole drama of 2018 are impressive. According to the media, the weekend drama's total production costs reached KRW40b, and the drama should prove a massive commercial success thanks to: 1) Netflix buying global copyrights to the drama; and 2) lofty weekend primetime ad slot prices (KRW18.4m, which exceeds that charged by terrestrial broadcasters).

**2Q preview:** Our estimates have the company's 2Q operating profit rising 1.4% y-y to KRW9.3b, just shy of consensus (KRW10.3b) due to an absence of tentpole dramas (ie, insignificant overseas sales; excludes the sale of Live copyright to Netflix). Nonetheless, strong viewership ratings for its dramas have highlighted the firm's progress in enhancing content quality. My Mister and What's Wrong with Secretary Kim (both are broadcast on Wednesdays and Thursdays) have secured high viewership ratings, while Lawless Lawyer and Mr. Sunshine (both are aired on Saturdays and Sundays) have made a big splash.

**Raising target to KRW140,000:** We revise up our 12-month target price by 40% to KRW140,000 though the current price looks somewhat demanding. Its per-episode production costs recently surged to KRW1.7b (vs KRW300m-500m, previously) on: 1) greater demand from Netflix for Korean content; and 2) the growing potential of the global OTT market (which includes China). Its present market cap (KRW3t) is justified by an average production cost of KRW1.2b/episode. Considering that US content production costs exceeds KRW4b on average per episode, we believe that Studio Dragon's production costs will rise over the mid- to long term, buoying its earnings.

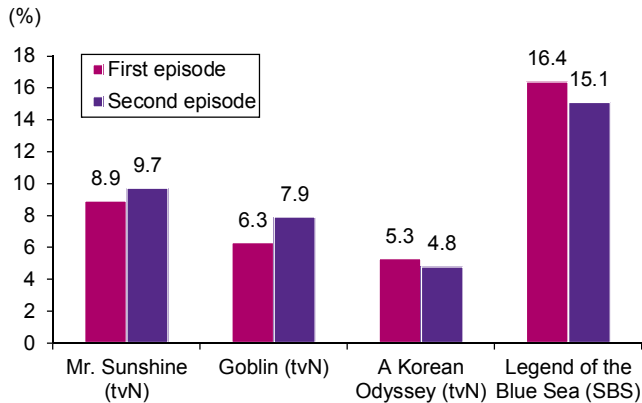
- **Upside momentum:** The popularity of Mr. Sunshine, the conclusion of a production contract for Netflix Original Series dramas in 2H18, and the signing of contracts with Chinese OTT operators
- **Downside risks:** Delays in content production/signing supply contracts, and the falling valuation of growth stocks

### SUMMARY FINANCIAL DATA

	2017	2018E	2019E	2020E
Revenue (KRWb)	287	378	499	640
Net profit (adj) (KRWb)	24	40	67	93
EPS (adj) (KRW)	1,050	1,441	2,391	3,324
EPS (adj) growth (% y-y)	84.5	37.2	65.9	39.0
EBITDA margin (%)	25.9	30.2	34.6	35.8
ROE (%)	9.5	10.4	15.2	17.8
P/E (adj) (x)	114.1	83.1	50.1	36.0
P/B (x)	9.1	8.2	7.1	5.9
EV/EBITDA (x)	42.8	27.5	17.8	12.9
Dividend yield (%)	0.0	0.0	0.0	0.0

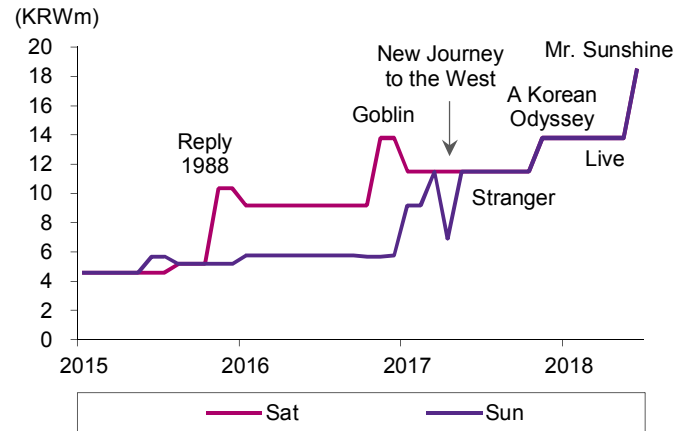
Source: Company data, Samsung Securities estimates

Chart 1. Tentpole drama viewership ratings



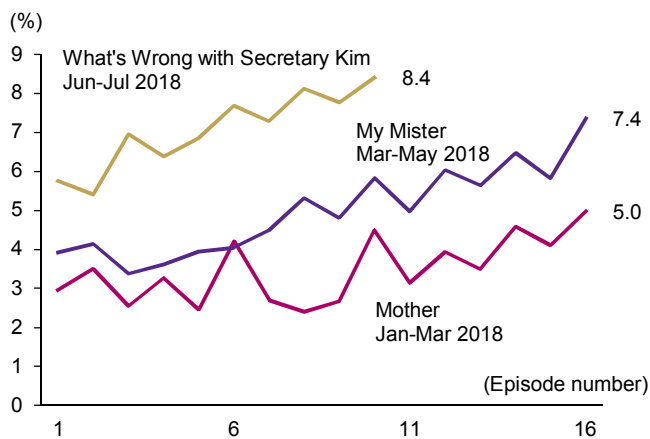
Source: AGB Nielson Media Research

Chart 2. CJ ENM: Prime-time unit ad price



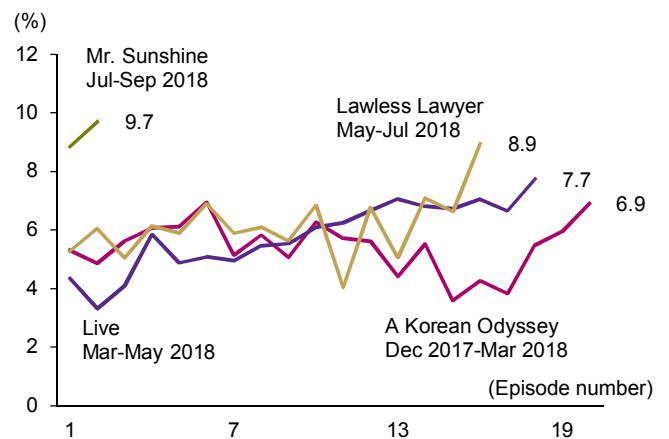
Source: Company data

Chart 3. tvN: Wednesday and Thursday drama ratings









Source: AGB Nielson Media Research

Chart 4. tvN: Weekend drama ratings



Source: AGB Nielson Media Research

Table 1. Netflix original series production costs

(USDm)	House of Cards	Orange Is the New Black	Marco Polo	Sense8	The Get Down	The Crown
						
Cost per season	60	50	90	108	120	130
Cost per episode	4.6	3.8	9.0	9.0	10.9	13.0
Year	2013-	2013-	2014-2016	2015-2018	2016-2017	2016-

Source: Local media, Samsung Securities

### Revising up target to KRW140,000

#### Uncertainties regarding overseas copyright sales

The biggest challenge in our target price calculation is forecasting the degree of earnings that overseas copyright sales will bring in. We believe that Studio Dragon's global copyright sales to Netflix will drive up its production costs, which should prove to be the greatest source of earnings growth momentum. Mr. Sunshine's total production costs reached a reported KRW40b or KRW1.7b per episode, far higher than its past average of KRW300m-500m/episode but still below the figures at its US and Chinese peers. If the company starts supplying dramas to Chinese OTT operators, its production costs could climb further.

#### Production costs to rise over mid- to long term

Based on long-term assumptions—of a P/E of 20x, a net margin of 15%, and production of 40 dramas *pa*—Studio Dragon's current market cap would imply a per-drama production cost of KRW20b. This would be below its assumed 3Q18 figure (of KRW13b, which includes Mr. Sunshine), but should prove easily attainable, as: 1) the company's tentpole drama production costs are trending upwards; and 2) the firm may come to produce more dramas as Netflix Original Series. Our new target price of KRW140,000 is based on a production cost assumption of KRW23b per drama and KRW100b per tentpole drama (see table 3).

**Table 2. Target price calculation**

(KRWb)	Current	Target	2016	2017	2018E	2019E	Note
Share-price (KRW)	119,800	140,000					
Market cap	3,359	3,925					
Net profit	168	196	13	24	40	67	Market cap/A
Sales	1,120	1,308	196	287	378	499	Net profit/B
Per-drama sales	28	33	10.3	12.9	15.1	17.1	Sales/C
Per-drama production cost	20	23	7.8	9.5	10.8	11.7	Per-drama sales*D
Per-episode production cost	1.2	1.4	0.48	0.59	0.67	0.73	Per-drama production cost/E
<b>&lt;Assumptions&gt;</b>							
Target P/E (x)	20	20	264.6	140.9	83.0	50.0	A
Net margin (%)	15.0	15.0	6.5	8.3	10.7	13.5	B
Number of dramas	40	40	19	22	25	29	C
Weight of production cost (%)	70.0	70.0	75.4	73.1	71.3	68.4	D
Number of episodes in a drama	16	16	16	16	16	16	E

Source: Samsung Securities estimates

**Table 3. Production cost estimates**

(KRWb)	Number of dramas	Average production cost	Total production cost
Tentpole	6	100	600
General	34	10	323
Total	40	23	923

Source: Samsung Securities

**Table 4. Co-production discussions with global firms**

Company	Plans
Amazon	<ul style="list-style-type: none"> <li>Distribute dramas in Japan</li> </ul>
Warner Bros.	<ul style="list-style-type: none"> <li>Signed co-production MOU</li> <li>Co-produce global dramas</li> </ul>
Netflix	<ul style="list-style-type: none"> <li>Distribute new dramas</li> <li>Co-produce global dramas</li> </ul>
AMC (US)	<ul style="list-style-type: none"> <li>Co-produce global dramas</li> </ul>
ITV (UK)	<ul style="list-style-type: none"> <li>Co-produce global dramas</li> </ul>

Source: Company data

Table 5. Results and forecasts

(KRWb)	2017	2018E	2019E	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18E	3Q18E	4Q18E	1Q19E	2Q19E	3Q19E	4Q19E
<b>Sales</b>	<b>287</b>	<b>378</b>	<b>499</b>	<b>75</b>	<b>62</b>	<b>77</b>	<b>72</b>	<b>80</b>	<b>64</b>	<b>115</b>	<b>119</b>	<b>119</b>	<b>123</b>	<b>127</b>	<b>130</b>
Broadcasting	131	155	209	26	24	42	39	41	27	41	46	49	51	53	55
Copyright sales	112	193	256	36	26	23	26	32	29	67	65	61	64	65	66
Other	44	30	34	13	12	12	7	7	7	8	8	8	8	9	9
<b>Cost of goods sold</b>	<b>240</b>	<b>307</b>	<b>390</b>	<b>59</b>	<b>50</b>	<b>67</b>	<b>64</b>	<b>66</b>	<b>51</b>	<b>94</b>	<b>97</b>	<b>92</b>	<b>96</b>	<b>99</b>	<b>103</b>
Production	210	269	341	49	42	60	58	59	44	81	85	80	84	87	90
Commission	17	29	38	5	4	3	4	5	4	10	10	9	10	10	10
Other	13	9	10	4	3	4	2	2	2	2	2	2	3	3	3
<b>Gross profit</b>	<b>47</b>	<b>70</b>	<b>109</b>	<b>17</b>	<b>12</b>	<b>11</b>	<b>7</b>	<b>14</b>	<b>13</b>	<b>21</b>	<b>22</b>	<b>27</b>	<b>27</b>	<b>28</b>	<b>27</b>
SG&A	14	17	20	3	3	4	4	3	4	5	5	4	5	6	6
<b>Operating profit</b>	<b>33</b>	<b>54</b>	<b>89</b>	<b>14</b>	<b>9</b>	<b>7</b>	<b>3</b>	<b>11</b>	<b>9</b>	<b>17</b>	<b>17</b>	<b>23</b>	<b>23</b>	<b>22</b>	<b>21</b>
Pre-tax profit	30	54	90	13	9	6	2	11	9	17	17	23	23	22	21
Net profit	24	40	67	13	3	6	2	8	7	13	13	17	17	17	16
Adjusted EPS (KRW)	1050	1,441	2,391												
<b>Margins (%)</b>															
Operating margin	11.5	14.2	17.9	18.5	14.3	8.6	4.8	13.4	14.6	14.4	14.5	19.4	18.4	17.4	16.4
Pre-tax margin	10.6	14.3	18.0	17.6	14.5	8.2	2.3	13.5	14.7	14.5	14.5	19.5	18.5	17.5	16.5
Net margin	8.3	10.7	13.5	17.8	4.5	7.3	2.8	9.9	11.0	10.9	10.9	14.6	13.9	13.1	12.4

Source: Company data, Samsung Securities estimates

## Income statement

Year-end Dec 31 (KRWb)	2016	2017	2018E	2019E	2020E
<b>Sales</b>	<b>154</b>	<b>287</b>	<b>378</b>	<b>499</b>	<b>640</b>
Cost of goods sold	133	240	307	390	499
<b>Gross profit</b>	<b>22</b>	<b>47</b>	<b>70</b>	<b>109</b>	<b>141</b>
Gross margin (%)	14.0	16.4	18.6	21.9	22.0
SG&A expenses	5	14	17	20	24
<b>Operating profit</b>	<b>17</b>	<b>33</b>	<b>54</b>	<b>89</b>	<b>117</b>
Operating margin (%)	10.8	11.5	14.2	17.9	18.3
<b>Non-operating gains (losses)</b>	<b>(6)</b>	<b>(3)</b>	<b>0</b>	<b>0</b>	<b>7</b>
Financial profit	1	1	4	5	7
Financial costs	2	3	0	(1)	(1)
Equity-method gains (losses)	0	0	0	0	0
Other	(5)	(0)	(4)	(5)	(0)
<b>Pre-tax profit</b>	<b>10</b>	<b>30</b>	<b>54</b>	<b>89</b>	<b>124</b>
Taxes	2	6	14	22	31
Effective tax rate (%)	22.4	21.2	25.4	25.0	25.0
Profit from continuing operations	8	24	40	67	93
Profit from discontinued operations	0	0	0	0	0
<b>Net profit</b>	<b>8</b>	<b>24</b>	<b>40</b>	<b>67</b>	<b>93</b>
Net margin (%)	5.3	8.3	10.7	13.4	14.6
Net profit (controlling interests)	8	24	40	67	93
Net profit (non-controlling interests)	0	0	0	0	0
EBITDA	39	74	114	173	229
EBITDA margin (%)	25.1	25.9	30.2	34.6	35.8
EPS (parent-based) (KRW)	569	1,050	1,441	2,391	3,324
EPS (consolidated) (KRW)	569	1,050	1,441	2,391	3,324
Adjusted EPS (KRW)*	569	1,050	1,441	2,391	3,324

## Cash flow statement

Year-end Dec 31 (KRWb)	2016	2017	2018E	2019E	2020E
<b>Cash flow from operations</b>	<b>(12)</b>	<b>(7)</b>	<b>118</b>	<b>174</b>	<b>233</b>
Net profit	8	24	40	67	93
Non-cash profit and expenses	27	46	71	101	136
Depreciation	0	0	0	0	0
Amortization	22	41	61	84	113
Other	5	5	10	17	24
Changes in A/L from operating activities	(46)	(73)	21	29	35
<b>Cash flow from investments</b>	<b>(70)</b>	<b>(141)</b>	<b>(94)</b>	<b>(106)</b>	<b>(134)</b>
Change in tangible assets	(1)	(0)	0	0	0
Change in financial assets	(2)	(142)	(8)	(9)	(10)
Other	(66)	1	(86)	(97)	(124)
<b>Cash flow from financing</b>	<b>93</b>	<b>188</b>	<b>(17)</b>	<b>1</b>	<b>1</b>
Change in debt	28	(18)	(16)	0	0
Change in equity	126	208	0	0	0
Dividends	0	0	0	0	0
Other	(60)	(2)	(0)	1	1
Change in cash	12	40	7	69	100
Cash at beginning of year	0	12	51	59	127
Cash at end of year	12	51	59	127	227
<b>Gross cash flow</b>	<b>35</b>	<b>70</b>	<b>111</b>	<b>168</b>	<b>230</b>
<b>Free cash flow</b>	<b>(14)</b>	<b>(7)</b>	<b>37</b>	<b>72</b>	<b>102</b>

Note: \* Excluding one off items, \*\* Fully diluted, excluding one-off items

\*\*\* From companies subject to equity-method valuation

Source: Company data, Samsung Securities estimates

## Balance sheet

Year-end Dec 31 (KRWb)	2016	2017	2018E	2019E	2020E
<b>Current assets</b>	<b>81</b>	<b>290</b>	<b>309</b>	<b>390</b>	<b>503</b>
Cash & equivalents	12	51	59	127	227
Accounts receivable	37	55	58	61	64
Inventories	0	1	1	1	1
Other current assets	33	182	191	201	211
<b>Fixed assets</b>	<b>161</b>	<b>170</b>	<b>200</b>	<b>220</b>	<b>240</b>
Investment assets	2	4	5	7	8
Tangible assets	1	1	1	1	1
Intangible assets	124	128	148	167	185
Other long-term assets	33	37	46	46	46
<b>Total assets</b>	<b>242</b>	<b>459</b>	<b>509</b>	<b>610</b>	<b>743</b>
<b>Current liabilities</b>	<b>84</b>	<b>91</b>	<b>100</b>	<b>134</b>	<b>174</b>
Accounts payable	6	6	8	11	14
Short-term debt	8	0	(7)	(7)	(7)
Other current liabilities	71	85	98	130	167
<b>Long-term liabilities</b>	<b>21</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>
Bonds & long-term debt	20	0	0	0	0
Other long-term liabilities	2	0	0	1	1
<b>Total liabilities</b>	<b>106</b>	<b>91</b>	<b>100</b>	<b>134</b>	<b>174</b>
<b>Owners of parent equity</b>	<b>136</b>	<b>368</b>	<b>409</b>	<b>476</b>	<b>569</b>
Capital stock	11	14	14	14	14
Capital surplus	115	320	320	320	320
Retained earnings	8	32	73	140	233
Other	2	3	3	3	3
<b>Non-controlling interests' equity</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total equity</b>	<b>136</b>	<b>368</b>	<b>409</b>	<b>476</b>	<b>569</b>
Net debt	16	(182)	(213)	(289)	(396)

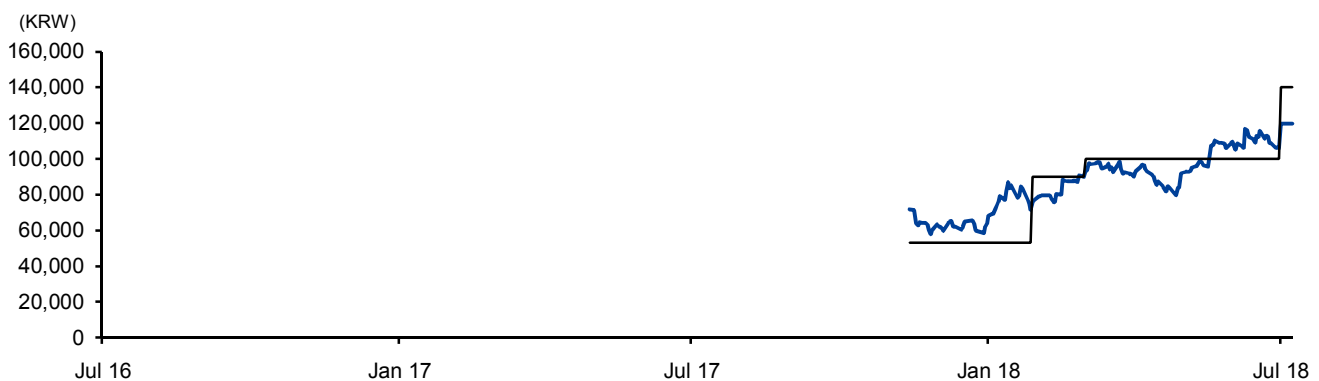
## Financial ratios

Year-end Dec 31	2016	2017	2018E	2019E	2020E
<b>Growth (%)</b>					
Sales	nm	85.7	31.7	32.0	28.3
Operating profit	nm	98.3	63.2	65.7	31.1
Net profit	nm	192.9	69.4	65.9	39.0
Adjusted EPS**	nm	84.5	37.2	65.9	39.0
<b>Per-share data (KRW)</b>					
EPS (parent-based)	569	1,050	1,441	2,391	3,324
EPS (consolidated)	569	1,050	1,441	2,391	3,324
Adjusted EPS**	569	1,050	1,441	2,391	3,324
BVPS	6,176	13,141	14,582	16,973	20,297
DPS (common)	0	0	0	0	0
<b>Valuations (x)</b>					
P/E***	210.5	114.1	83.1	50.1	36.0
P/B***	19.4	9.1	8.2	7.1	5.9
EV/EBITDA	87.0	42.8	27.5	17.8	12.9
<b>Ratios (%)</b>					
ROE	6.0	9.5	10.4	15.2	17.8
ROA	3.4	6.8	8.3	12.0	13.8
ROIC	8.5	15.6	21.6	36.2	51.1
Payout ratio	0.0	0.0	0.0	0.0	0.0
Dividend yield (common)	0.0	0.0	0.0	0.0	0.0
Net debt to equity	12.1	(49.4)	(52.1)	(60.7)	(69.6)
Interest coverage (x)	19.5	19.0	337.6	(150.3)	(197.1)

## Compliance notice

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## Target price changes in past two years



## Rating changes over past two years (adjusted share prices)

Date	2017/11/23	2018/2/8	3/13	7/12
Recommendation	BUY	BUY	BUY	BUY
Target price (KRW)	53,000	90,000	100,000	140,000
Gap* (average)	29.29	(7.62)	(1.06)	
(max or min)**	64.15	1.11	17.10	

Note: \* [(average, maximum, or minimum share price over duration of target price minus target price) / target price] x 100%

\*\* Maximum/minimum share price if new target is higher/lower than market close on the business day prior to target price change

Samsung Securities uses the following investment ratings.

### Company

<b>BUY</b>	Expected to increase in value by 10% or more within 12 months and is highly attractive within sector
<b>HOLD</b>	Expected to increase/decrease in value by less than 10% within 12 months
<b>SELL</b>	Expected to decrease in value by 10% or more within 12 months

### Industry

<b>OVERWEIGHT</b>	Expected to outperform market by 5% or more within 12 months
<b>NEUTRAL</b>	Expected to outperform/underperform market by less than 5% within 12 months
<b>UNDERWEIGHT</b>	Expected to underperform market by 5% or more within 12 months

## Percentage of ratings in 12 months prior to Jun 30, 2018

BUY (85.1%) | HOLD (14.9%) | SELL (0%)



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