

Studio Dragon (253450 KQ)

HJ Kim

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Rating **MARKETPERFORM**
maintain

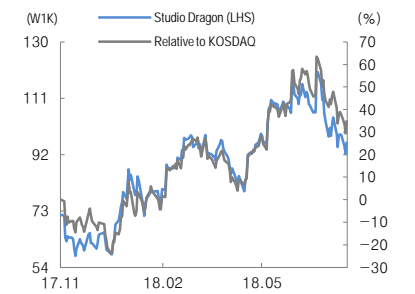
6M TP (₩) **95,000**
raise

CP (₩)
(18.08.08) **96,000**

Media

KOSDAQ	783.81
Market cap (₩bn)	2,692
Market cap portion (%)	1.04
Paid-in capital (common; ₩bn)	14
52w high/low (₩)	119,800 / 57,800
120d avg. trading volume (₩bn)	19.5
Foreign ownership (%)	2.73
Major shareholders	CJ E&M+3: 75.66%

(%)	1M	3M	6M	12M
Abs. return	-11.6	20.6	27.0	0.0
Rel. return	-8.8	27.3	39.6	0.0



Entry to China would justify current valuation

MARKETPERFORM maintained; 6M TP raised 17% to ₩95,000

- We have hiked our target price for Studio Dragon by 17% (derived from the residual income model) after revising up our forecast for the annual average revenue growth until 2022 to 36% from 31%, given that *Mr. Sunshine* has been sold to Netflix for about ₩30bn (which brightened the sales outlook for its tent poles). However, we reiterate our MARKETPERFORM rating as the current 2018E P/E is high at 49x (even when assuming that Studio Dragon will export one program to China for about ₩10bn in 2H18 as relations between Korea and China improve).

2Q18 results: Intellectual property revenue comes in low; margins narrow due to rising costs

- 2Q18 revenue expanded 20% yoy, but contracted 7% qoq to ₩74.3bn, while OP fell 18% yoy and 32% qoq to ₩7.3bn.

- Broadcasting revenue jumped 41% yoy to ₩34.1bn led by beefed up programming at tvN and OCN, but revenue from intellectual property (for instance, distribution deal with Netflix) grew somewhat less significantly (up by 9.5% yoy to ₩28.8bn). OP margin narrowed 18% yoy as COGS climbed 27.7% yoy to ₩63.7bn due to increased production and per-episode production cost of dramas. On a positive note, the average viewer rating of Studio Dragon's dramas rose 1.5%p yoy, indicating potential sales growth going forward. In particular, the newly added Wednesday-Thursday dramas have been well received by viewers despite them being aired during prime time (21:30) alongside terrestrial TV dramas. *My Mister* and *What's Wrong with Secretary Kim* are outperforming rival terrestrial TV dramas, with peak ratings of 7.4% and 8.7%, respectively.

- Studio Dragon collects television money from CJ E&M that amounts to about 70% of its drama production cost, while posting an average margin of about 20% from product placements and licensing deals. As such, its earnings vary significantly depending on the amount and timing of distribution rights sales. OP margin narrowed yoy and qoq to 9.9% in 2Q18, but it is predicted to rebound to 20% in 3Q18 as the company records revenue from rights sale of *What's Wrong with Secretary Kim*, *Mr. Sunshine*, and *Familiar Wife* in its books.

Successful deal with Netflix; current valuations can be justified once the company breaks into China

- *Mr. Sunshine*, whose production cost is an estimated ₩43bn, is said to have been sold to Netflix at about ₩30bn.

- Due to the high production cost, the amount of television money the company collected from CJ E&M is somewhat low, at about 35% of production cost. Furthermore, being a series inspired by historical events, there is a limited room for indirect ads. The amount of distribution rights sales to third parties other than Netflix will not be large. With this, we expect the production margin of *Mr. Sunshine* to be about 20%. It may be difficult to boost margins from tent poles such as *Mr. Sunshine*, but we believe such productions will help lift the company's revenue and earnings.

- As Netflix is not available in China yet, rights sales to China would directly increase Studio Dragon's earnings.

(Wbn, %)

	2Q17	1Q18	2Q18					3Q18		
			Previous estimate	Result	YoY	QoQ	Consensus	Daishin estimate	YoY	QoQ
Revenue	62	80	71	74	19.6	-7.0	68	131	68.8	76.1
OP	9	11	15	7	-18.0	-31.6	9	26	294.5	259.9
NP	3	8	13	9	217.5	13.1	10	21	269.6	135.3

	2016	2017	2018(F)				Growth	
			Previous estimate	Daishin estimate	Chg	Consensus	2017	2018(F)
Revenue	154	287	343	378	10.2	380	85.7	31.8
OP	17	33	71	66	-6.8	66	98.3	99.6
NP	8	24	57	55	-3.0	51	192.9	131.7

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	378	420	450
OP	17	33	66	82	97
Pretax profit	10	30	74	91	107
NP	8	24	55	68	79
NP (controlling int.)	8	24	55	68	79
EPS	5,691	1,050	1,971	2,408	2,825
PER	0.0	61.9	48.7	39.9	34.0
BPS	61,763	13,141	15,112	16,920	19,045
PBR	0.0	4.9	6.4	5.7	5.0
ROE	12.0	9.5	14.0	15.0	15.7

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

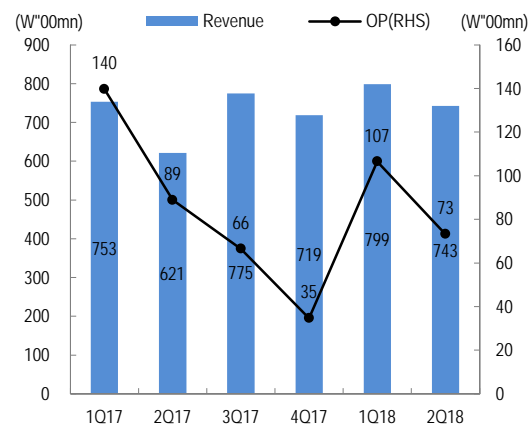
Yearly earnings forecast revision

(Wbn, W, %, %p)

	Previous		Revised		Chg	
	2018F	2019F	2018F	2019F	2018F	2019F
Revenue	343	367	378	420	10.2	14.5
Selling & adm. expense	11	13	13	13	12.3	0.2
OP	71	79	66	82	-6.8	3.2
OP margin	20.6	21.6	17.4	19.5	-3.2	-2.1
Non-operating profit	7	8	8	9	22.1	13.9
Pretax profit	77	88	74	91	-4.3	4.2
NP (controlling int.)	57	65	55	68	-3.0	4.2
NP margin	16.6	17.7	14.6	16.1	-2.0	-1.6
EPS (controlling int.)	2,032	2,312	1,971	2,408	-3.0	4.2

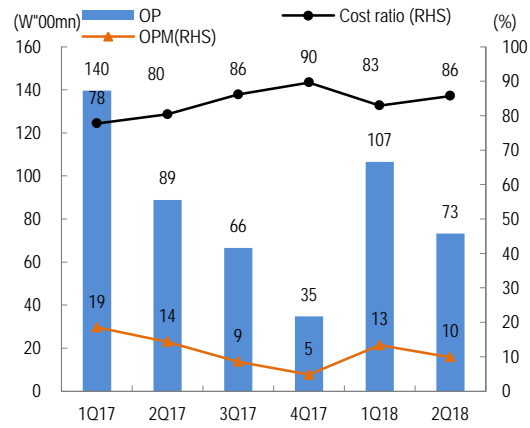
Source: Studio Dragon, Daishin Securities Research Center

Fig 1. Revenue and OP



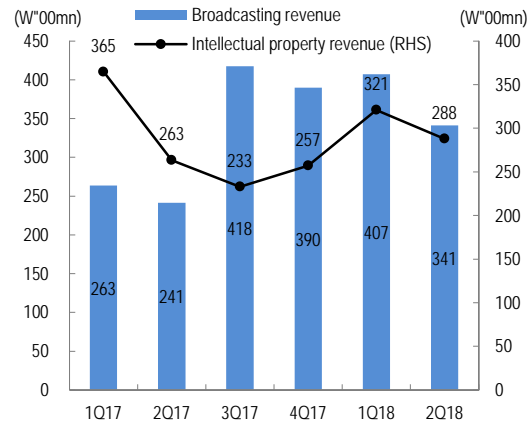
Source: Studio Dragon, Daishin Securities Research Center

Fig 2. OP, OP margin, and cost ratio



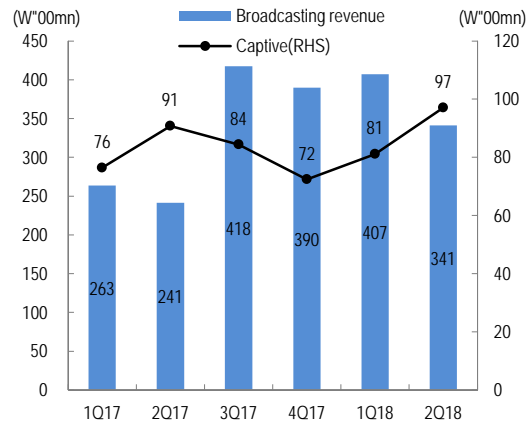
Source: Studio Dragon, Daishin Securities Research Center

Fig 3. Broadcasting revenue vs. intellectual property revenue



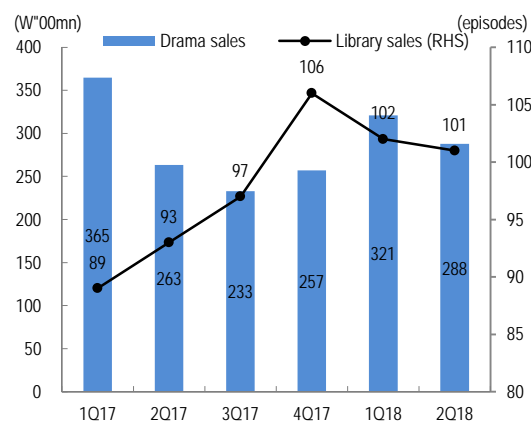
Source: Studio Dragon, Daishin Securities Research Center

Fig 4. Captive customers account for 97.1% of broadcasting revenue



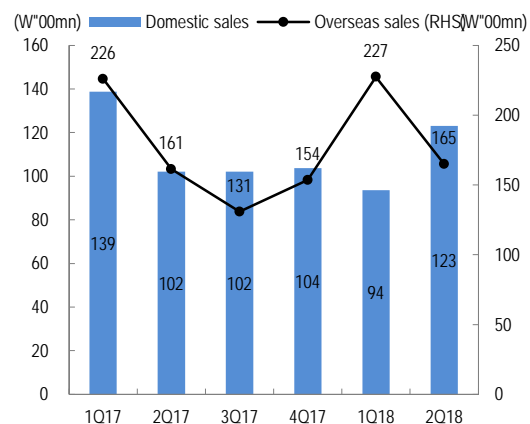
Source: Studio Dragon, Daishin Securities Research Center

Fig 5. IPR sales



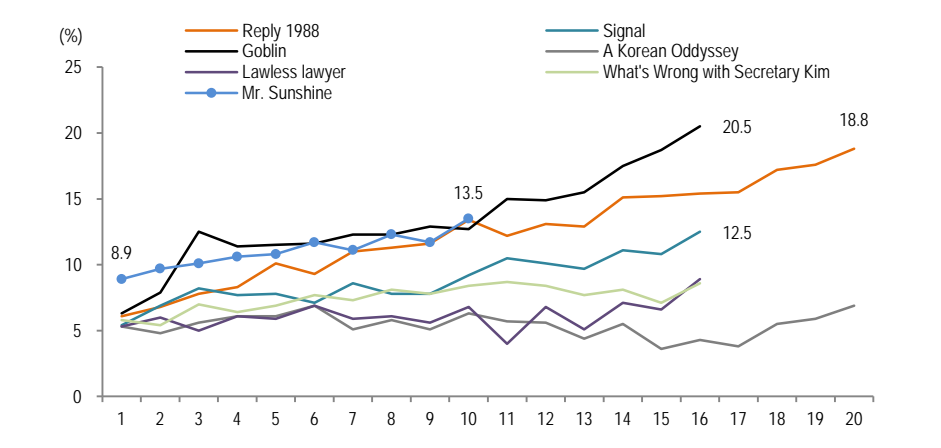
Source: Studio Dragon, Daishin Securities Research Center

Fig 6. Domestic sales vs. overseas sales



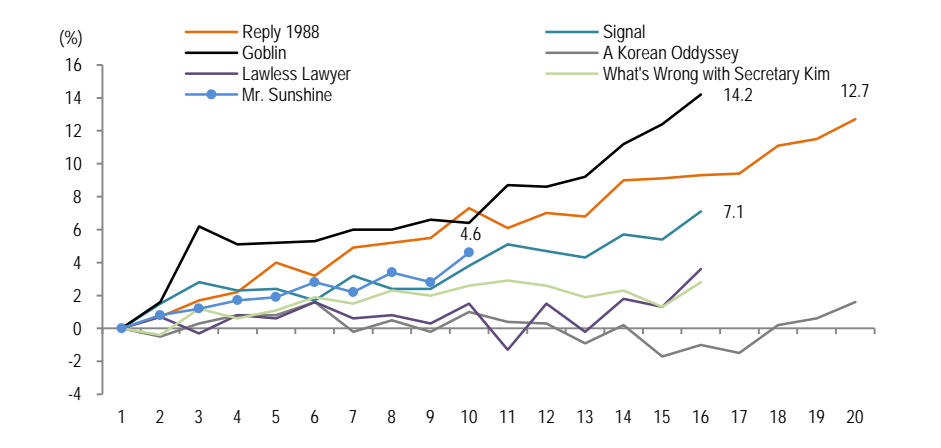
Source: Studio Dragon, Daishin Securities Research Center

Fig 7. Viewer ratings of Studio Dragon dramas that posted a viewer rating of 5% or higher at the premiere episode



Source: AGB Nielson, Daishin Securities Research Center

Fig 8. Change in viewer ratings of Studio Dragon dramas that posted a viewer rating of 5% or higher at the premiere episode



Source: AGB Nielson, Daishin Securities Research Center

Fig 9. An ad endorsing Mr. Sunshine



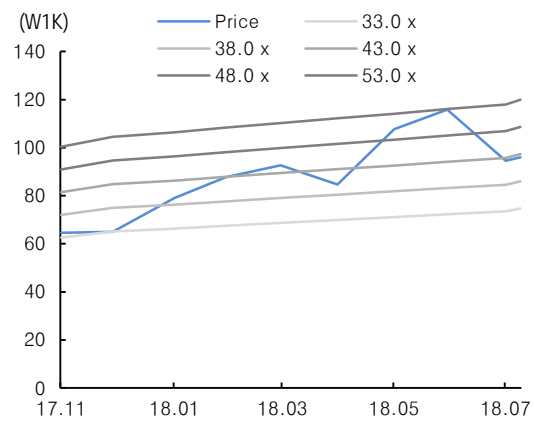
Source: Wisefn, Daishin Securities Research Center

Fig 10. A virtual ad endorsing Mr. Sunshine



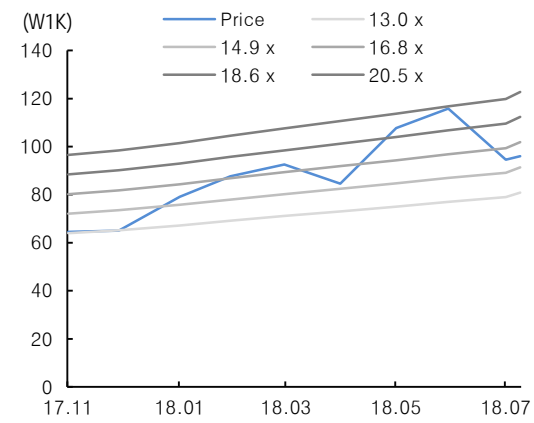
Source: Wisefn, Daishin Securities Research Center

Fig 11. 12MF P/E band



Source: Wisefn, Daishin Securities Research Center

Fig 12. 12MF EV/EBITDA band



Source: Wisefn, 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)	55	68	79	94	112	127	144	162	183	207
II	Shareholders' equity (contr. int.) ^(Note 2)	424	474	534	534	604	696	795	907	1,026	1,160
	Estimated ROE	14.0	15.0	15.7	17.7	18.6	18.2	18.0	17.9	17.9	17.9
III	Required rate of return ^(Note 3)	5.5									
	Risk free rate of return ^(Note 4)	2.3									
	Market risk premium ^(Note 5)	4.0									
	Beta	0.80									
IV	Spread (estimated ROE – required rate of return)	8.5	9.5	10.2	12.2	13.1	12.7	12.5	12.4	12.4	12.4
V	Required income	20	23	26	29	29	33	38	44	50	56
VI	Residual income (I - V)	35	44	53	65	83	94	105	118	133	151
	Present value factor	0.98	0.93	0.88	0.84	0.79	0.75	0.71	0.67	0.64	0.61
	PV of residual income	34	41	47	54	66	70	75	80	85	91
VII	Sum of residual income	645									
VIII	PV of residual income following forecasting period	1,662									
	Terminal growth (g) ^(Note 6)	0.0%									
IX	Beginning shareholders' equity	368									
X	Fair market cap (VII+VIII+IX)	2,675									
	Total number of shares (thousands)	28,037									
XI	Per share value (W)	95,404									
	Current share price (W)	96,000									
	Potential (%)	-0.6%									

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	378	420	450
Cost of goods sold	133	240	299	326	339
Gross profit	22	47	79	95	111
S&A expenses	5	14	13	13	14
OP	17	33	66	82	97
OP margin	10.8	11.5	17.4	19.5	21.5
EBITDA	39	74	124	173	193
Non-OP	-6	-3	8	9	10
Income from affiliates	0	0	0	0	0
Financial revenue	1	1	8	9	10
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	74	91	107
Income tax expense	-2	-6	-19	-24	-28
Income from cont. op.	8	24	55	68	79
Income from discount. op.	0	0	0	0	0
NP	8	24	55	68	79
NP margin	5.3	8.3	14.6	16.1	17.6
NP for non-contr. interest	0	0	0	0	0
NP for contr. interest	8	24	55	68	79
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	0	0	0	0	0
Comprehensive income	8	24	55	67	79
Comp. income for non-contr. int.	0	0	0	0	0
Comp. income for contr. int.	8	24	55	67	79

Valuation metrics (W, x, %)					
	2016A	2017A	2018F	2019F	2020F
EPS	5,691	1,050	1,971	2,408	2,825
PER	0.0	61.9	48.7	39.9	34.0
BPS	61,763	13,141	15,112	16,920	19,045
PBR	0.0	4.9	6.4	5.7	5.0
EBITDAPS	27,127	3,271	4,435	6,166	6,877
EVEBITDA	0.4	22.1	19.9	14.2	12.5
SPS	107,949	12,628	13,483	14,986	16,043
PSR	0.0	5.1	7.1	6.4	6.0
CFPS	24,684	3,351	4,514	6,267	6,974
DPS	0	0	600	700	850

Financial ratios (W, x, %)					
	2016A	2017A	2018F	2019F	2020F
Growth potential					
Revenue growth	na	85.7	31.8	11.1	7.0
OP growth	na	98.3	99.6	24.3	18.4
NP growth	na	192.9	131.7	22.2	17.3
Profitability					
ROIC	19.4	17.0	26.5	28.8	31.1
ROA	13.7	9.4	13.6	15.4	16.5
ROE	12.0	9.5	14.0	15.0	15.7
Stability					
Debt ratio	77.8	24.7	19.6	17.7	15.8
Net borrowings ratio	12.1	-49.4	-50.0	-50.6	-52.5
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	327	364	410
Cash & cash equiv.	12	51	71	99	139
Trade & other receive.	39	55	73	81	87
Inventories	0	1	2	2	2
Other current assets	31	182	182	182	182
Long-term assets	161	170	179	194	209
Tangible assets	1	1	1	1	1
Investments in affiliates	0	0	0	0	0
Other long-term assets	159	169	178	194	208
Total assets	242	459	507	558	618
Current liabilities	84	91	83	84	84
Payables & other liab.	23	34	36	37	37
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	83	84	84
Controlling interest	136	368	424	474	534
Capital stock	11	14	14	14	14
Capital surplus	115	320	320	320	320
Retained earnings	8	32	87	138	198
Other capital changes	2	3	3	3	3
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	136	368	424	474	534
Net borrowings	16	-182	-212	-240	-280

Cash flow statement (Wbn)					
	2016A	2017A	2018F	2019F	2020F
Operating cash flows	-12	-7	34	88	106
NP	8	24	55	68	79
Non-cash items	27	52	71	108	116
Depreciation	22	41	59	91	96
FX gains	0	1	0	0	0
Equity method gain	0	0	0	0	0
Others	5	10	13	17	20
Chg in assets & liab.	-46	-73	-82	-73	-71
Other cash flows	-2	-10	-10	-14	-18
Investing cash flow	-70	-141	-68	-106	-110
Investment assets	0	-1	0	0	0
Tangible assets	-1	0	0	0	0
Others	-68	-140	-68	-106	-110
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	20	28	40
Beginning cash balance	0	12	51	71	99
Ending cash balance	12	51	71	99	139
NOPLAT	13	26	49	61	72
FCF	34	67	39	45	57

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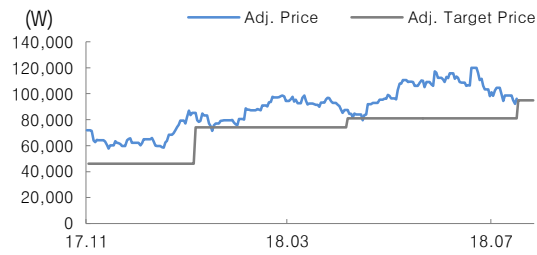
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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Date	18.08.09	18.04.29	18.01.28	17.11.25
Rating	Marketperform	Marketperform	Marketperform	Buy
Target price	95,000	81,000	74,000	46,000
Diff. (avr. %)		26.68	19.40	44.64
Diff. (max/min., %)		(1.73)	(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 (Aug 6, 2018)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	82.1%	15.8%	1.1%

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.