

Studio Dragon (253450 KQ)

HJ Kim
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Rating **BUY**
upgrade

6M TP (W) **115,000**

CP (W) (18.11.07) **97,500**
raise

Media

Expanding beyond Korea

Upgraded to BUY; TP bumped up to W115,000

- We hike our target price for Studio Dragon by 21% as we now see a 41% CAGR for the soap opera production company through 2022, up from our previous projection of 36%.
- Revenue from TV drama rights surged 172% yoy in the latest quarter thanks to the hit show "Mr. Sunshine." We see a strong chance of the company scoring a deal for its new drama "Memories of the Alhambra" with Chinese media firms.

3Q18 highlight: Strong overseas performance

- Studio Dragon's third-quarter performance fell slightly short of our expectations, reporting revenue of W120bn (up 67% qoq; up 60% yoy) and OP of W21.5bn (up 194% qoq; up 223% yoy).
- What's encouraging is the impressive growth in TV rights sales, up 172% to W63.4bn that accounted for more than half (51%) of total revenue in that quarter. The strong performance owes to higher price tag for its dramas (up 154% yoy to W610mn per title) and increased exports* (approximately 73% of TV rights revenue came from overseas business).

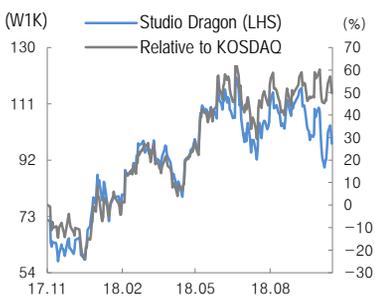
* Netflix paid roughly W30bn for the rights to offer "Mr. Sunshine" (highest viewer rating 18.1%) on its streaming platform. The high-price deal shows the strong potential of Korea's tentpole TV shows in the global market.

- The company is poised to re-enter the China market with the sale of its new drama "Memories of the Alhambra" (set to go on the air in December), which looks highly likely. It is also pursuing a coproduction agreement with a Chinese partner.
- The renewed China business will help justify the stock's pricey valuation. (See our August report.)
- We project the company to produce 30 new dramas in 2019, up from our previous estimate of 25. OP margin will also increase (to 20% from our prior projection of 16%) in that year as the content creator sees more TV rights revenue flowing in from overseas (Netflix W30bn and China W20bn).

Industry 4.0 safety rating ■ Sky Blue

| | |
|--------------------------------|------------------|
| KOSDAQ | 682.37 |
| Market cap (Wbn) | 2,734 |
| Market cap portion (%) | 1.20 |
| Paid-in capital (common; Wbn) | 14 |
| 52w high/low (W) | 119,800/57,800 |
| 120d avg. trading volume (Wbn) | 20.3 |
| Foreign ownership (%) | 2.37 |
| Major shareholders | CJ E&M+3: 75.66% |

| (%) | 1M | 3M | 6M | 12M |
|-------------|-------|------|------|-----|
| Abs. return | -10.2 | 5.7 | 16.2 | 0.0 |
| Rel. return | 1.8 | 21.6 | 45.8 | 0.0 |



| | 3Q17 | 2Q18 | 3Q18 | | | | | 4Q18 | | |
|---------|------|------|-------------------|--------|-------|-------|-----------|------------------|-------|-------|
| | | | Previous estimate | Result | YoY | QoQ | Consensus | Daishin estimate | YoY | QoQ |
| Revenue | 78 | 74 | 131 | 124 | 59.6 | 66.5 | 122 | 91 | 26.8 | -26.3 |
| OP | 7 | 7 | 26 | 22 | 223.4 | 193.6 | 24 | 20 | 470.6 | -7.9 |
| NP | 6 | 9 | 21 | 17 | 205.1 | 94.4 | 21 | 16 | 690.4 | -8.6 |

Operating results and major financial data

| | 2016A | 2017A | 2018F | 2019F | 2020F |
|-----------------------|--------|--------|--------|--------|--------|
| Revenue | 154 | 287 | 369 | 435 | 463 |
| OP | 17 | 33 | 59 | 85 | 117 |
| Pretax profit | 10 | 30 | 65 | 93 | 125 |
| NP | 8 | 24 | 50 | 69 | 93 |
| NP (controlling int.) | 8 | 24 | 50 | 69 | 93 |
| EPS | 5,691 | 1,050 | 1,776 | 2,462 | 3,309 |
| PER | 0.0 | 61.9 | 54.9 | 39.6 | 29.5 |
| BPS | 61,763 | 13,141 | 14,917 | 16,780 | 19,389 |
| PBR | 0.0 | 4.9 | 6.5 | 5.8 | 5.0 |
| ROE | 12.0 | 9.5 | 12.7 | 15.5 | 18.3 |

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

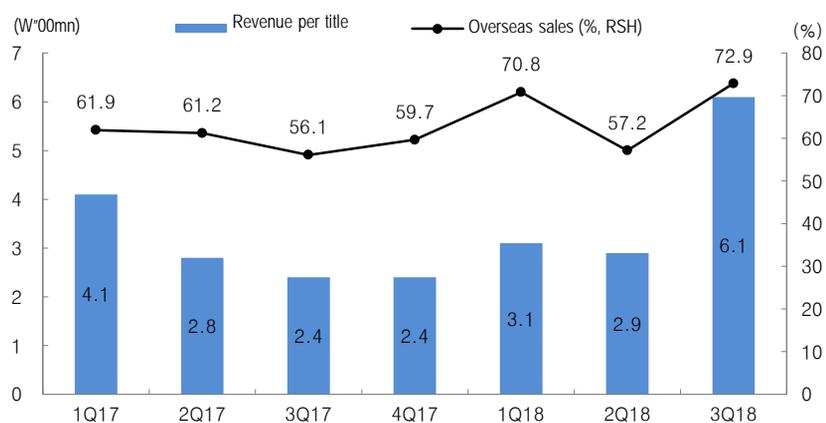
Yearly earnings forecast revision

(Wbn, W, %, %p)

| | Previous | | Revised | | Chg | |
|------------------------|----------|-------|---------|-------|-------|-------|
| | 2018F | 2019F | 2018F | 2019F | 2018F | 2019F |
| Revenue | 378 | 420 | 369 | 435 | -2.4 | 3.5 |
| S&A expense | 13 | 13 | 14 | 13 | 11.6 | -0.2 |
| OP | 66 | 82 | 59 | 85 | -9.9 | 3.9 |
| OP margin | 17.4 | 19.5 | 16.1 | 19.6 | -1.4 | 0.1 |
| Non-operating profit | 8 | 9 | 6 | 8 | -25.5 | -12.2 |
| Pretax profit | 74 | 91 | 65 | 93 | -11.6 | 2.2 |
| NP (controlling int.) | 55 | 68 | 50 | 69 | -9.9 | 2.2 |
| NP margin | 14.6 | 16.1 | 13.5 | 15.9 | -1.1 | -0.2 |
| EPS (controlling int.) | 1,971 | 2,408 | 1,776 | 2,462 | -9.9 | 2.2 |

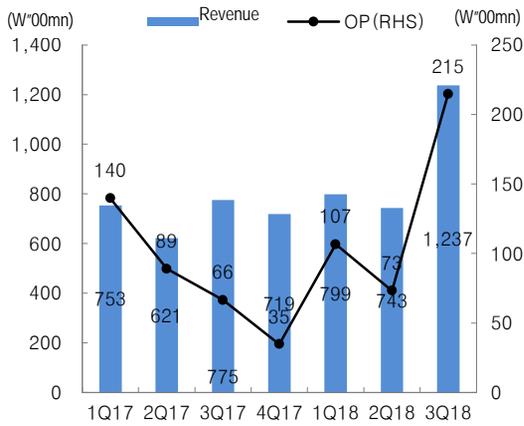
Source: Studio Dragon, Daishin Securities Research Center

Fig 1. Overseas content sales



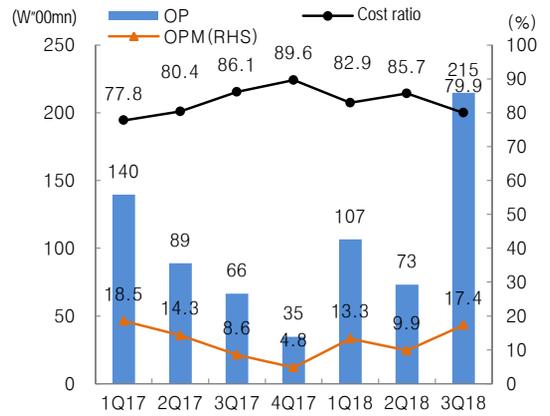
Source: Studio Dragon, Daishin Securities Research Center

Fig 2. Revenue and OP



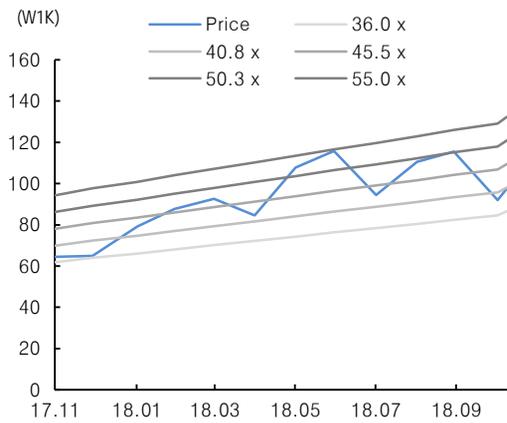
Source: Studio Dragon, Daishin Securities Research Center

Fig 3. OP margin and cost ratio



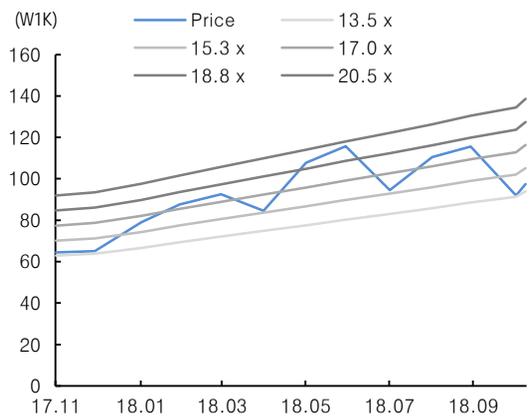
Source: Studio Dragon, Daishin Securities Research Center

Fig 4. 12M FWD PER Band



Source: Wisefn, Daishin Securities Research Center

Fig 5. 12M FWD EV/EBITDA Band



Source: Wisefn, Daishin Securities Research Center

Company profile

Overview

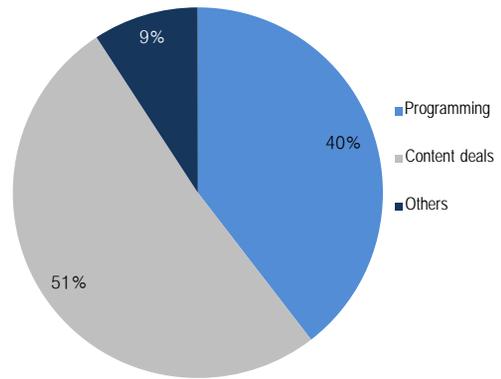
- Spun off from CJ E&M in May, 2016
- Listed on the KOSDAA in Nov. 2017
- 2017 results (W'00mn): Revenue 2,868, OP 330, NP 79
- 3Q18 revenue mix: Programming 40%, Content deals 51%, Others 9%
- Major shareholder: CJ E&M +6 (75.66%)

Stock catalysts

- Drama programming (tvN, OCN)
- Deals with Netflix and Chinese media firms

Source: Studio Dragon, Daishin Securities Research Center

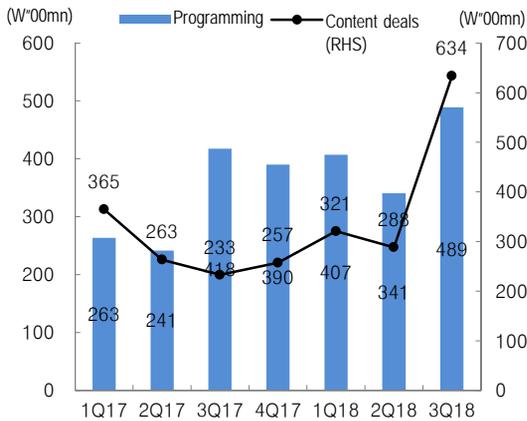
Revenue mix (3Q18)



Source: Studio Dragon, Daishin Securities Research Center

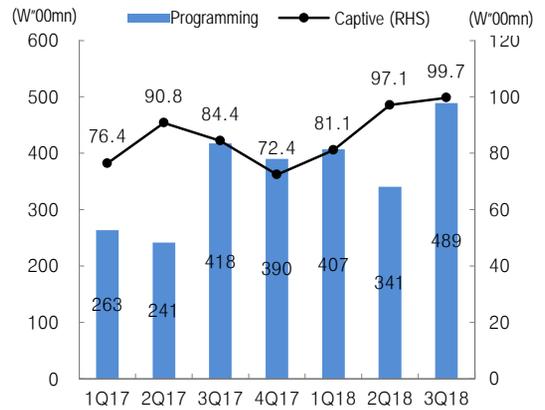
Earnings drivers

Fig 6. Revenue



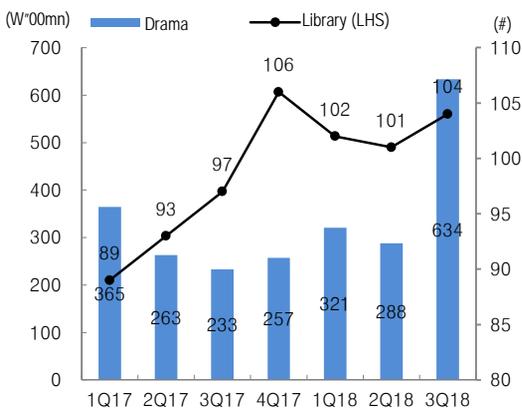
Source: Studio Dragon, Daishin Securities Research Center

Fig 7. Captive revenue



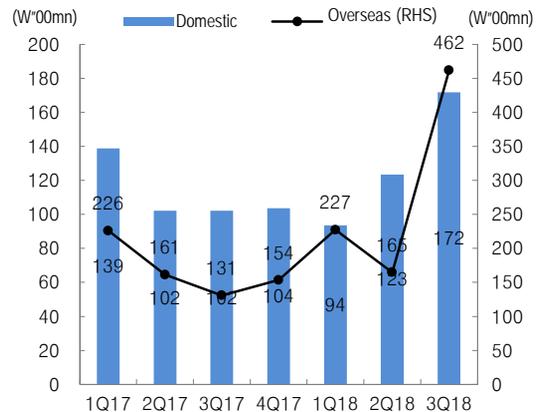
Source: Studio Dragon, Daishin Securities Research Center

Fig 8. Drama sales



Source: Studio Dragon, Daishin Securities Research Center

Fig 9. Sales: Domestic vs. Overseas



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) | 50 | 69 | 93 | 116 | 133 | 153 | 176 | 193 | 213 | 234 |
| II | Shareholders' equity (contr. int.) ^(Note 2) | 418 | 470 | 544 | 544 | 637 | 762 | 885 | 1,016 | 1,152 | 1,301 |
| | Estimated ROE | 12.7 | 15.5 | 18.3 | 21.4 | 20.9 | 20.1 | 19.9 | 19.0 | 18.5 | 18.0 |
| III | Required rate of return ^(Note 3) | 5.3 | | | | | | | | | |
| | Risk free rate of return ^(Note 4) | 2.1 | | | | | | | | | |
| | Market risk premium ^(Note 5) | 4.0 | | | | | | | | | |
| | Beta | 0.80 | | | | | | | | | |
| IV | Spread (estimated ROE – required rate of return) | 7.4 | 10.2 | 13.0 | 16.1 | 15.6 | 14.8 | 14.6 | 13.7 | 13.2 | 12.7 |
| V | Required income | 20 | 22 | 25 | 29 | 29 | 34 | 40 | 47 | 54 | 61 |
| VI | Residual income (I - V) | 30 | 47 | 68 | 87 | 104 | 119 | 135 | 147 | 159 | 173 |
| | Present value factor | 1.00 | 0.95 | 0.90 | 0.85 | 0.81 | 0.77 | 0.73 | 0.69 | 0.66 | 0.63 |
| | PV of residual income | 30 | 44 | 61 | 74 | 84 | 92 | 99 | 102 | 105 | 108 |
| VII | Sum of residual income | 799 | | | | | | | | | |
| VIII | PV of residual income following forecasting period | 2,042 | | | | | | | | | |
| | Terminal growth (g) ^(Note 6) | 0.0% | | | | | | | | | |
| IX | Beginning shareholders' equity | 368 | | | | | | | | | |
| X | Fair market cap (VII+VIII+IX) | 3,210 | | | | | | | | | |
| | Total number of shares (1K) | 28,037 | | | | | | | | | |
| XI | Per share value (W) | 114,477 | | | | | | | | | |
| | Current share price (W) | 97,500 | | | | | | | | | |
| | Upside potential (%) | 17.4% | | | | | | | | | |

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 | 369 | 435 | 463 |
| Cost of goods sold | 133 | 240 | 295 | 337 | 333 |
| Gross profit | 22 | 47 | 74 | 98 | 131 |
| SG&A expenses | 5 | 14 | 14 | 13 | 14 |
| OP | 17 | 33 | 59 | 85 | 117 |
| OP margin | 10.8 | 11.5 | 16.1 | 19.6 | 25.1 |
| EBITDA | 39 | 74 | 118 | 184 | 216 |
| Non-OP | -6 | -3 | 6 | 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 | 65 | 93 | 125 |
| Income tax expense | -2 | -6 | -15 | -24 | -33 |
| Income from cont. op. | 8 | 24 | 50 | 69 | 93 |
| Income from discount. op. | 0 | 0 | 0 | 0 | 0 |
| NP | 8 | 24 | 50 | 69 | 93 |
| NP margin | 5.3 | 8.3 | 13.5 | 15.9 | 20.0 |
| NP for non-contr. interest | 0 | 0 | 0 | 0 | 0 |
| NP for contr. interest | 8 | 24 | 50 | 69 | 93 |
| Valuation of AFS fin. assets | 0 | 0 | 0 | 0 | 0 |
| Other compreh. income | 0 | 0 | 0 | 0 | 0 |
| Comprehensive income | 8 | 24 | 50 | 69 | 93 |
| Comp. income for non-contr. int. | 0 | 0 | 0 | 0 | 0 |
| Comp. income for contr. int. | 8 | 24 | 50 | 69 | 93 |

| Valuation metrics | (W, x, %) | | | | |
|-------------------|-----------|--------|--------|--------|--------|
| | 2016A | 2017A | 2018F | 2019F | 2020F |
| EPS | 5,691 | 1,050 | 1,776 | 2,462 | 3,309 |
| PER | 0.0 | 61.9 | 54.9 | 39.6 | 29.5 |
| BPS | 61,763 | 13,141 | 14,917 | 16,780 | 19,389 |
| PBR | 0.0 | 4.9 | 6.5 | 5.8 | 5.0 |
| EBITDAPS | 27,127 | 3,271 | 4,226 | 6,569 | 7,713 |
| EVEBITDA | 0.4 | 22.1 | 21.5 | 13.6 | 11.3 |
| SPS | 107,949 | 12,628 | 13,163 | 15,504 | 16,528 |
| PSR | 0.0 | 5.1 | 7.6 | 6.5 | 6.1 |
| CFPS | 24,684 | 3,351 | 4,269 | 6,670 | 7,810 |
| DPS | 0 | 0 | 600 | 700 | 800 |

| Financial ratios | (W, x, %) | | | | |
|-------------------------|-----------|-------|-------|-------|-------|
| | 2016A | 2017A | 2018F | 2019F | 2020F |
| Growth potential | | | | | |
| Sales growth | na | 85.7 | 28.7 | 17.8 | 6.6 |
| OP growth | na | 98.3 | 79.8 | 43.4 | 37.1 |
| NP growth | na | 192.9 | 108.8 | 38.6 | 34.4 |
| Profitability | | | | | |
| ROIC | 19.4 | 17.0 | 23.4 | 28.3 | 36.0 |
| ROA | 13.7 | 9.4 | 12.3 | 16.1 | 19.7 |
| ROE | 12.0 | 9.5 | 12.7 | 15.5 | 18.3 |
| Stability | | | | | |
| Debt ratio | 77.8 | 24.7 | 19.8 | 17.9 | 15.6 |
| Net borrowings ratio | 12.1 | -49.4 | -45.8 | -47.9 | -52.1 |
| 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 | 305 | 352 | 416 |
| Cash & cash equiv. | 12 | 51 | 51 | 85 | 142 |
| Trade & other receive. | 39 | 55 | 71 | 84 | 89 |
| Inventories | 0 | 1 | 2 | 2 | 2 |
| Other current assets | 31 | 182 | 182 | 182 | 182 |
| Long-term assets | 161 | 170 | 196 | 202 | 213 |
| Tangible assets | 1 | 1 | 1 | 1 | 1 |
| Investments in affiliates | 0 | 0 | 0 | 0 | 0 |
| Other long-term assets | 159 | 169 | 195 | 202 | 212 |
| Total assets | 242 | 459 | 501 | 555 | 628 |
| Current liabilities | 84 | 91 | 82 | 84 | 84 |
| Payables & other liab. | 23 | 34 | 36 | 37 | 38 |
| 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 | 85 |
| Controlling interest | 136 | 368 | 418 | 470 | 544 |
| Capital stock | 11 | 14 | 14 | 14 | 14 |
| Capital surplus | 115 | 320 | 320 | 320 | 320 |
| Retained earnings | 8 | 32 | 82 | 134 | 207 |
| Other capital changes | 2 | 3 | 3 | 3 | 3 |
| Non-controlling interest | 0 | 0 | 0 | 0 | 0 |
| Total shareholder's equity | 136 | 368 | 418 | 470 | 544 |
| Net borrowings | 16 | -182 | -192 | -226 | -283 |

| Cash flow statement | (Wbn) | | | | |
|------------------------|-------|-------|-------|-------|-------|
| | 2016A | 2017A | 2018F | 2019F | 2020F |
| Operating cash flows | -12 | -7 | 31 | 93 | 124 |
| NP | 8 | 24 | 50 | 69 | 93 |
| Non-cash items | 27 | 52 | 70 | 118 | 126 |
| Depreciation | 22 | 41 | 59 | 99 | 100 |
| FX gains | 0 | 1 | 0 | 0 | 0 |
| Equity method gain | 0 | 0 | 0 | 0 | 0 |
| Others | 5 | 10 | 11 | 19 | 26 |
| Chg in assets & liab. | -46 | -73 | -80 | -78 | -71 |
| Other cash flows | -2 | -10 | -8 | -16 | -24 |
| Investing cash flow | -70 | -141 | -85 | -106 | -110 |
| Investment assets | 0 | -1 | 0 | 0 | 0 |
| Tangible assets | -1 | 0 | 0 | 0 | 0 |
| Others | -68 | -140 | -85 | -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 | -1 | 34 | 58 |
| Beginning cash balance | 0 | 12 | 51 | 51 | 85 |
| Ending cash balance | 12 | 51 | 51 | 85 | 142 |
| NOPLAT | 13 | 26 | 45 | 63 | 86 |
| FCF | 34 | 67 | 19 | 56 | 76 |

[Daishin House View:1 Industry 4.0 safety rating]

- Daishin Securities assigns safety ratings to individual sectors and companies based on analyses and discussions by our analysts.
- Depending on whether Industry 4.0 will have a positive, neutral, or negative impact, each industry and company is assigned one of three safety ratings:

Dark Gray (negative)

Neutral Green (neutral)

Sky Blue (positive)

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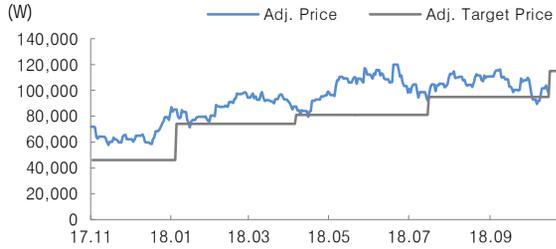
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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



| Date | 18.11.08 | 18.08.08 | 18.04.29 | 18.01.28 | 17.11.25 |
|----------------------|----------|---------------|---------------|---------------|----------|
| Rating | Buy | Marketperform | Marketperform | Marketperform | Buy |
| Target price | 115,000 | 95,000 | 81,000 | 74,000 | 46,000 |
| Diff. (avr. %) | | 10.81 | 26.80 | 19.40 | 44.64 |
| Diff. (max./min., %) | | 22.42 | (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 (Nov. 5, 2018)

| | BUY | MARKETPERFORM | UNDERPERFORM |
|-------|-------|---------------|--------------|
| Ratio | 84.3% | 14.7% | 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.