

# Studio Dragon (253450 KQ)

HJ Kim

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Rating **BUY**  
maintain

6M TP (₩) **115,000**  
maintain

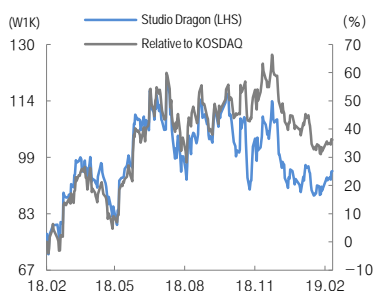
CP (₩)  
(19.02.14) **94,600**

Media

Industry 4.0 safety rating ■ Sky Blue

KOSDAQ	742.27
Market cap (Wbn)	2,654
Market cap portion (%)	1.06
Paid-in capital (common; Wbn)	14
52w high/low (₩)	119,800 / 75,800
120d avg. trading volume (Wbn)	16.8
Foreign ownership (%)	2.42
Major shareholders	CJ ENM+3: 74.35%

(%)	1M	3M	6M	12M
Abs. return	-1.5	-9.3	-8.8	19.0
Rel. return	-9.3	-17.9	-6.4	35.9



## Top-line expansion solid

### BUY and 6M TP of ₩115,000 maintained

- The target price of ₩115,000 is derived from our residual income model to better reflect the company's long-term earnings performance. The production house is forecast to achieve CAGR of 35% in NP over the next five years and boost its TV drama lineup from 25 to 40.

### 4Q18 earnings underperformance is a temporary phenomenon

- For 4Q18, Studio Dragon reported OP of ₩0.4bn (down 89% yoy; 98% qoq) on revenue of ₩100bn (up 41% yoy; down 18% qoq). These are in line with expectations if excluding ₩13.5bn in one-off expenses (₩11.0bn in additional amortization of rights and ₩2.5bn in bonus payments).
- Studio Dragon passes about 70% of the production cost of TV dramas it creates to CJ ENM, which then sells TV ads and generates revenue in excess of what it had paid to the production house. The company recognizes the rest of the production cost (30%) as an intangible asset, which is then amortized over a period of one year and a half. If a TV drama is determined non-marketable, its remaining value is written down.
- Content sales to large platforms such as Netflix can help improve the company's top- and bottom-line results via additional revenue and rights amortization. But if unsuccessful, these may dampen the company's financial performance as they won't generate additional revenue and the rights will be written down immediately.
- That was the case in 4Q18. Ten dramas (including *Mr. Sunshine*), once considered to have great potential on Chinese platforms, were deemed non-marketable, which caused the company to write down their remaining value in that quarter.
- But investors should take these simply as conservative accounting treatments and do not reflect their views on the Chinese market.

### Earnings to soon return to normal; short-term share price movements will hinge on viewer ratings and Netflix stock price

- Studio Dragon, which increased its drama production volume by four to 26 in 2018, will further raise it by five to 31 this year. It will sell 25 of them to tvN and OCN and gradually ramp up production of Netflix Originals and terrestrial TV dramas. It will produce four Netflix Originals this year.
- China has yet to open up its market (for simultaneous broadcasting) to Korea again, but Studio Dragon's earnings are expected to return to normal soon, given that the company is likely to team up with a Chinese company to co-produce two dramas and J Contentree recently began to sell some of its old dramas to China.
- Studio Dragon's share price will be influenced by the viewer ratings of tentpole dramas and Netflix's share price until its earnings return to normal. Shares in Netflix plunged 44% in 2H18, but have rebound 54% from the trough seen late last year. With *Asadal Chronicles*, the most anticipated drama for this year, set to air on tvN in 1H19, the share price is primed to climb higher down the road.

(Wbn, %)

	4Q17	3Q18	Previous estimate	Result	4Q18			1Q19		
					YoY	QoQ	Consensus	Daishin estimate	YoY	QoQ
Revenue	72	124	97	102	41.4	-17.8	104	86	8.0	-15.1
OP	3	21	10	0.4	-88.5	-98.1	11	18	72.7	4,500.0
NP	2	17	9	2	-17.4	-90.5	9	15	92.7	818.9

	2016	2017	Previous estimate	Daishin estimate	2018(F)		Growth	
					Chg	Consensus	2017	2018(F)
Revenue	154	287	374	380	1.4	382	85.7	32.4
OP	17	33	50	40	-19.6	52	98.3	20.8
NP	8	24	43	36	-16.1	44	192.9	49.9

Source: Studio Dragon, FnGuide, Daishin Securities Research Center

Operating results and major financial data

(Wbn, W, x, %)

	2016A	2017A	2018F	2019F	2020F
Revenue	154	287	380	426	464
OP	17	33	40	73	88
Pretax profit	10	30	46	81	97
NP	8	24	36	60	72
NP (controlling int.)	8	24	36	60	72
EPS	5,691	1,050	1,275	2,134	2,561
PER	0.0	61.9	74.2	44.3	36.9
BPS	61,763	13,141	14,409	16,543	18,454
PBR	0.0	4.9	6.6	5.7	5.1
ROE	12.0	9.5	9.3	13.8	14.6

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

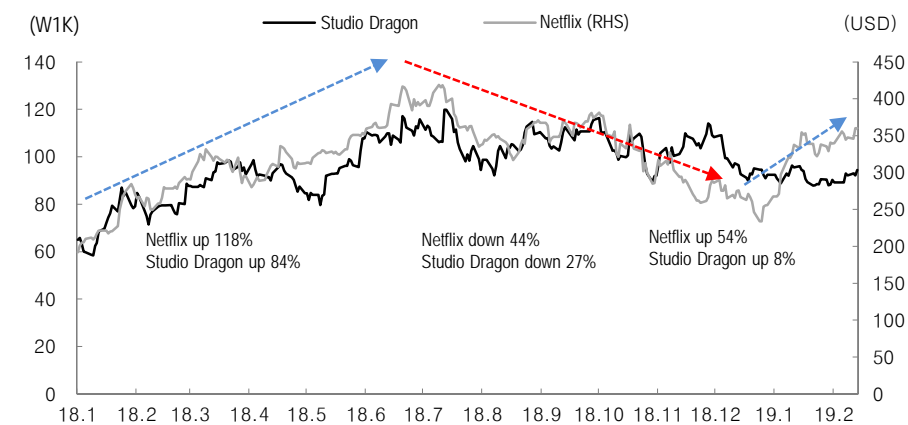
Yearly earnings forecast revision

(Wbn, W, %, %p)

	Previous		Revised		Chg	
	2018F	2019F	2018F	2019F	2018F	2019F
Revenue	374	440	380	426	1.4	-3.3
SG&A expense	14	13	16	11	9.8	-13.4
OP	50	73	40	73	-19.6	-0.5
OP margin	13.2	16.6	10.5	17.1	-2.7	0.5
Non-operating profit	6	8	6	8	-3.4	0.0
Pretax profit	56	81	46	81	-17.8	-0.5
NP (controlling int.)	43	60	36	60	-16.1	-0.5
NP margin	11.4	13.7	9.4	14.1	-2.0	0.4
EPS (controlling int.)	1,519	2,144	1,275	2,134	-16.1	-0.5

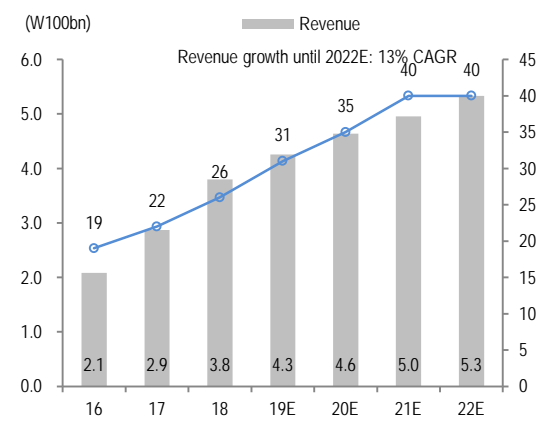
Source: Studio Dragon, Daishin Securities Research Center

Fig 1. Share price: Netflix vs. Studio Dragon



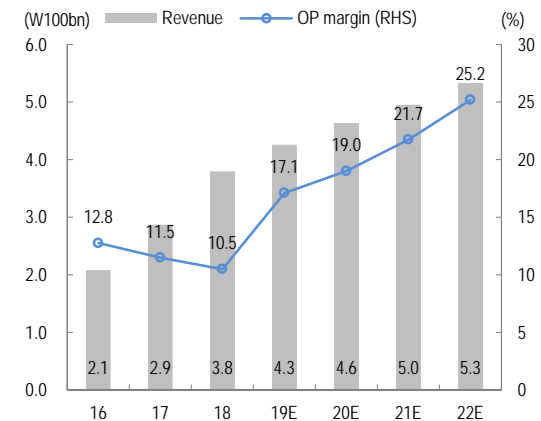
Source: Daishin Securities Research Center

Fig 2. Revenue rising in tandem with production volume



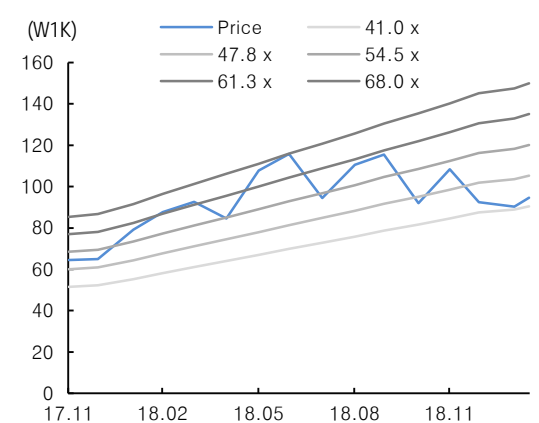
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 3. Margin improves as library expands



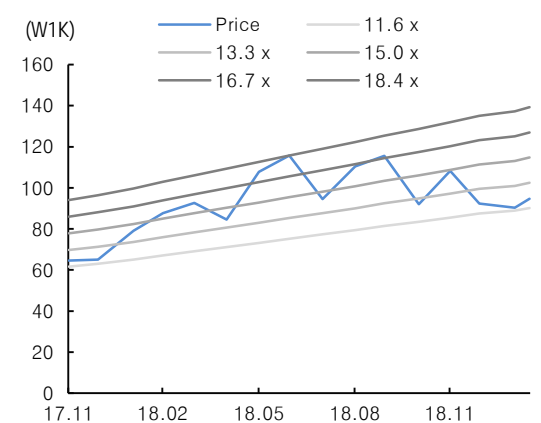
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 4. 12MF P/E band



Source: Wisefn, Daishin Securities Research Center

Fig 5. 12MF EV/EBITDA band

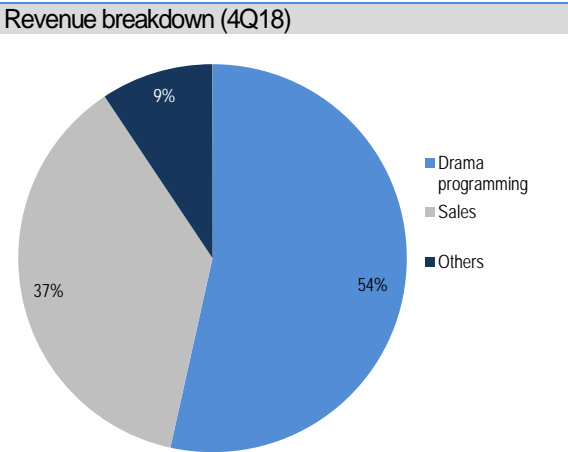


Source: Wisefn, Daishin Securities Research Center

1. Company profile

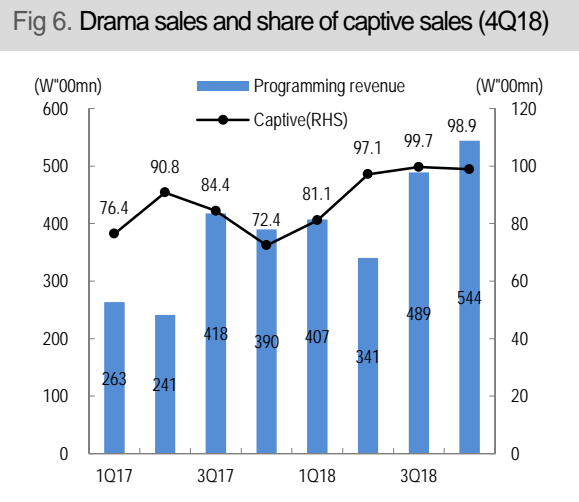
- Overview
- Spun off from CJ ENM in May 2016; listed on the KOSDAQ in Nov 2017
  - Revenue ₩379.6bn, OP ₩39.9bn, NP ₩35.8bn (2018)
  - 4Q18 revenue breakdown: dramas 54%, content sales 37%, and other 9%.
  - Major shareholders as of 3Q18: CJ ENM +6 (75.66%)
- Share price catalysts
- The share price has been rising since the stock market listing as: 1) tvN and OCN are increasing the number of dramas they air; and 2) Studio Dragons supplies dramas to Netflix as well.
  - Deals with Netflix and Chinese media platforms.

Source: Studio Dragon, Daishin Securities Research Center

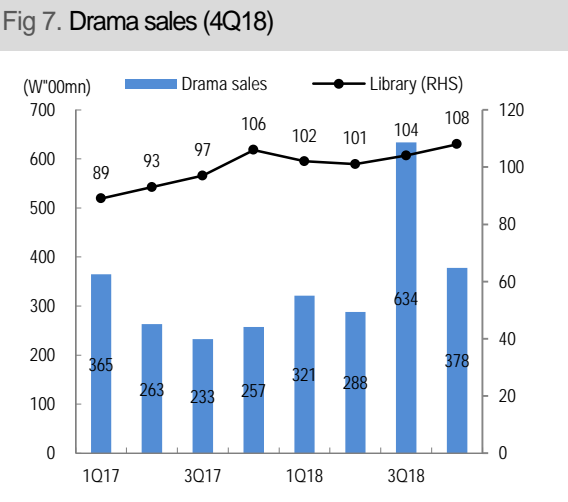


Source: Studio Dragon, Daishin Securities Research Center

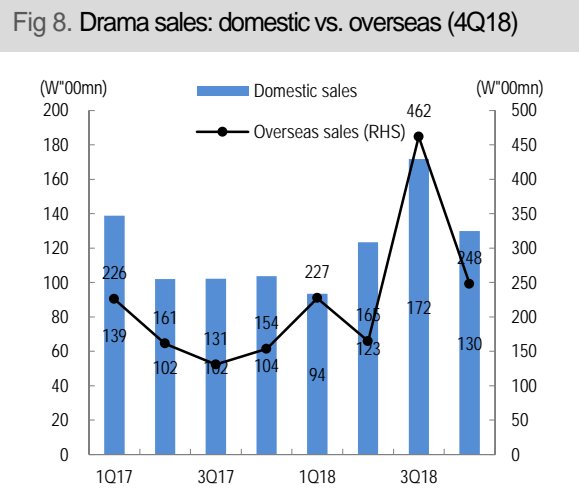
2. Earnings drivers



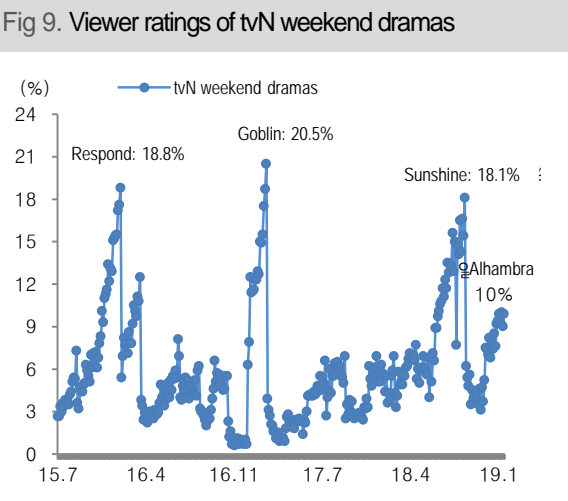
Source: Studio Dragon, Daishin Securities Research Center



Source: Studio Dragon, Daishin Securities Research Center



Source: Studio Dragon, Daishin Securities Research Center



Source: AGB Nielson, Daishin Securities Research Center

## Financial statements

Income statement (Wbn)					
	2016A	2017A	2018F	2019F	2020F
Revenue	154	287	380	426	464
Cost of goods sold	133	240	324	342	364
Gross profit	22	47	56	84	100
SG&A expenses	5	14	16	11	12
OP	17	33	40	73	88
OP margin	10.8	11.5	10.5	17.1	19.0
EBITDA	39	74	138	196	233
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	1	0	0
Others	-5	0	0	1	1
Income before taxes	10	30	46	81	97
Income tax expense	-2	-6	-10	-21	-25
Income from cont. op.	8	24	36	60	72
Income from discount. op.	0	0	0	0	0
NP	8	24	36	60	72
NP margin	5.3	8.3	9.4	14.1	15.5
NP for non-contr. interest	0	0	0	0	0
NP for contr. interest	8	24	36	60	72
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	0	0	0	0	0
Comprehensive income	8	24	36	60	72
Comp. income for non-contr. int.	0	0	0	0	0
Comp. income for contr. int.	8	24	36	60	72

Valuation metrics (W, x, %)					
	2016A	2017A	2018F	2019F	2020F
EPS	5,691	1,050	1,275	2,134	2,561
PER	0.0	61.9	74.2	44.3	36.9
BPS	61,763	13,141	14,409	16,543	18,454
PBR	0.0	4.9	6.6	5.7	5.1
EBITDAPS	27,127	3,271	4,924	6,995	8,306
EV/EBITDA	0.4	22.1	18.0	12.6	10.5
SPS	107,949	12,628	13,538	15,169	16,537
PSR	0.0	5.1	6.8	6.2	5.7
CFPS	24,684	3,351	5,007	7,096	8,402
DPS	0	0	0	650	800

Financial ratios (W, x, %)					
	2016A	2017A	2018F	2019F	2020F
<b>Growth potential</b>					
Sales growth	na	85.7	32.4	12.1	9.0
OP growth	na	98.3	20.8	82.2	21.5
NP growth	na	192.9	49.9	67.5	20.0
<b>Profitability</b>					
ROIC	19.4	17.0	16.5	23.6	24.4
ROA	13.7	9.4	8.2	13.3	14.6
ROE	12.0	9.5	9.3	13.8	14.6
<b>Stability</b>					
Debt ratio	77.8	24.7	27.5	24.1	21.8
Net borrowings ratio	12.1	-49.4	-40.5	-38.8	-38.1
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	250	276	301
Cash & cash equiv.	12	51	23	39	56
Trade & other receive.	39	55	73	82	89
Inventories	0	1	2	2	2
Other current assets	31	182	153	153	153
Long-term assets	161	170	265	300	330
Tangible assets	1	1	1	1	1
Investments in affiliates	0	0	0	0	0
Other long-term assets	159	169	264	300	329
Total assets	242	459	515	576	631
Current liabilities	84	91	108	109	110
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	72	72	72
Long-term liabilities	21	0	3	3	3
Borrowings	20	0	0	0	0
Convertible securities	0	0	0	0	0
Other long-term liab.	2	0	3	3	3
Total liabilities	106	91	111	112	113
Controlling interest	136	368	404	464	518
Capital stock	11	14	14	14	14
Capital surplus	115	320	320	320	320
Retained earnings	8	32	68	128	181
Other capital changes	2	3	3	3	3
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	136	368	404	464	518
Net borrowings	16	-182	-164	-180	-197

Cash flow statement (Wbn)					
	2016A	2017A	2018F	2019F	2020F
Operating cash flows	-12	-7	52	112	146
NP	8	24	36	60	72
Non-cash items	27	52	105	139	164
Depreciation	22	41	98	124	145
FX gains	0	1	-3	0	0
Equity method gain	0	0	0	0	0
Others	5	10	9	16	19
Chg in assets & liab.	-46	-73	-82	-74	-73
Other cash flows	-2	-10	-6	-13	-16
Investing cash flow	-70	-141	-169	-159	-174
Investment assets	0	-1	0	0	0
Tangible assets	-1	0	0	0	0
Others	-68	-140	-169	-159	-174
Financing cash flows	93	188	-12	-2	-20
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	0	-18
Others	10	-22	-12	-2	-2
Net chg in cash	12	40	-29	16	17
Beginning cash balance	0	12	51	23	39
Ending cash balance	12	51	23	39	56
NOPLAT	13	26	31	54	65
FCF	34	67	-40	18	36

[Daishin House View: Industry 4.0 safety rating]

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- 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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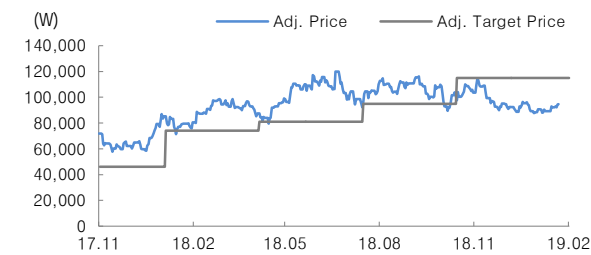
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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Date	19.02.15	18.11.07	18.08.08	18.04.29	18.01.28	17.11.25
Rating	BUY	BUY	MKTPERF.	MKTPERF.	MKTPERF.	BUY
Target price	115,000	115,000	95,000	81,000	74,000	46,000
Diff. (avr. %)		(15.75)	10.95	26.80	19.40	44.64
Diff. (max/min., %)		(0.78)	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 (Feb 12, 2018)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	85.6%	13.2%	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.