

February 15, 2019

Danny Lee Analyst
Internet, Game, Media, Leisure
82-2-6114-2960 drlee@kbfg.com

Jeonghoon Son RA
82-2-6114-2910
jhson@kbfg.com

Maintain BUY; Target price cut to KRW125,000; Key investment points remain valid

We retain our BUY rating on Studio Dragon, but cut the target price to KRW125,000. The target price was adjusted as 2019-20 NP attributable to parent were each revised down 8.0% and 2.6% considering delayed contents sales to China and a growing burden of amortization expenses amid rising production costs. Yet, we continue to favor the company as the top pick of the media sector due to the validity of positive investment points, such as 1) the anticipated receipt and broadcasts of original content orders from Netflix, and co-production of contents with Chinese OTT operators.

Earnings shock in 4Q18; Earnings in line with consensus when considering KRW11.0bn in one-off amortization expenses

Studio Dragon turned in OR of KRW101.7bn (+41.5% YoY, -17.7% QoQ) and OP of KRW0.4bn (-87.3% YoY, -97.9% QoQ) in 4Q18. OR continued fast-paced growth thanks to successful contents, including "Memories of the Alhambra" and "Boyfriend." When disregarding the KRW11.0bn in one-off amortization expenses, OR and OP were both in line with market consensus.

Amortization expenses become burden due to rising production costs and delayed sales in China

Studio Dragon was forced to book KRW11.0bn in one-off amortization expenses due to the delayed sales in China of 10 programs produced in 2018. Due to the production of "Mr. Sunshine," "Memories of the Alhambra," and other blockbuster contents, end-2018 amortization costs increased by KRW71.0bn YoY to KRW198.5bn. Average production costs and amortization expenses are expected to continue rising sharply in 2019 considering the scheduled production of two tent-pole series (including "Asadal Chronicles"), two Netflix originals, and the anticipated co-production of two programs with Chinese partners. Revenue leverage occurs only when programing and licensing sales climb along with production costs.

Buy maintain

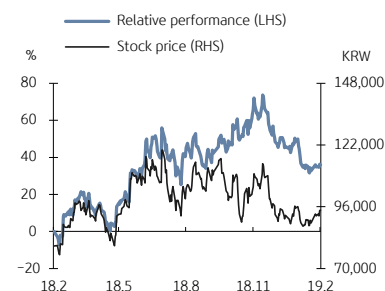
Target Price (lowered)	KRW125,000
Upside/Downside	32.1%
Current price (Feb 14)	KRW94,600
Consensus Target Price	KRW136,529
Market cap	USD2.4bn

Trading Data	
Free float	25.2%
Avg T/O Val (3M, KRWbn)	16.6
Foreign ownership	2.4%
Major shareholders	CJ E&M Corporation and 3 others
	74.4%

Share price performance					
(%)	1M	3M	6M	12M	
Absolute	-1.5	-9.3	-8.8	19.0	
Relative	-9.3	-17.9	-6.4	35.9	

Forecast earnings & valuation

FY-end	2018E	2019E	2020E	2021E
OR (KRWbn)	380	485	595	717
OP (KRWbn)	40	91	125	158
NP to parent (KRWbn)	36	71	97	124
EPS (KRW)	1,278	2,526	3,461	4,402
EPS Growth (%)	21.7	97.7	37.0	27.2
PER (x)	72.3	37.4	27.3	21.5
EV/EBITDA (x)	22.2	16.7	15.0	12.3
PBR (x)	6.4	5.6	4.7	3.8
ROE (%)	9.3	16.2	18.6	19.6
Div. Yield (%)	0.0	0.0	0.0	0.0

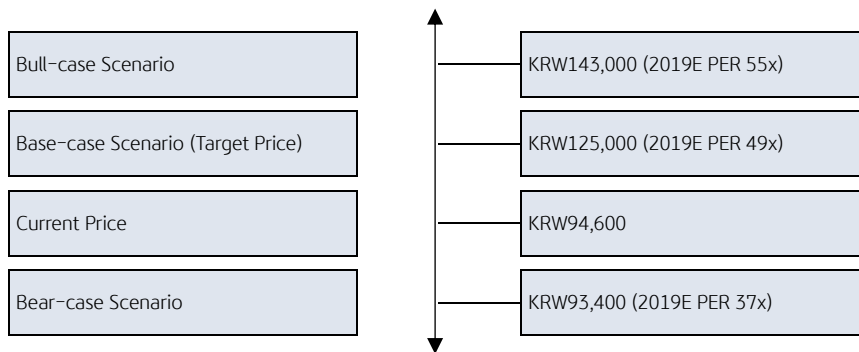


Source: Studio Dragon, KB Securities estimates

Co-production deals in China crucial to share price performance in 2019

Studio Dragon is currently discussing the co-production of two drama series based on its proprietary IPs with Chinese OTT operators. Since there are many instances of remakes using Korean IPs in talent shows (“Produce 101”) and movies (“Veteran”), a deal involving Korean IP-based remakes seem more likely to materialize than airing Korean contents directly in China. The company’s share price performance in 2019 is likely to be determined by the prospects of Studio Dragon’s business in China resuming after three years.

Investment opinion and risks



Base-case Scenario: Catalysts

- 1) Proprietary production of Netflix original dramas
- 2) Sales to China increase in 2019

Bull-case Scenario: Upside risks

- 1) Number of Netflix original drama productions increase
- 2) Sales to China soar in 2019

Bear-case Scenario: Downside risks

- 1) Sales to China decrease in 2019
- 2) Number of Netflix original drama productions decrease

Revised earnings estimates

(KRWbn, %)	Previous		Revised		Change	
	2018P	2019E	2018E	2019E	2018P	2019E
OR	380.3	491.0	379.5	483.3	-0.2	-1.6
OP	50.7	94.9	39.9	91.0	-21.3	-4.1
NP to parent	43.3	77.1	35.7	70.9	-17.5	-8.0

Source: KB Securities estimates

Difference vs. Consensus

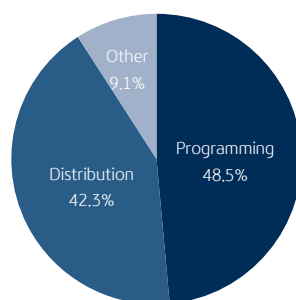
(KRWbn, %)	KB est.		Consensus		Difference	
	2018P	2019E	2018E	2019E	2018P	2019E
OR	379.5	483.3	381.5	506.3	-0.5	-4.5
OP	39.9	91.0	52.5	92.9	-23.9	-2.0
NP to parent	35.7	70.9	44.5	75.3	-19.7	-5.9

Source: Fnguide, KB Securities estimates

Valuation and target price calculation

- 1) Valuation method:
PER Valuation
- 2) Target price calculation:
2020E EPS KRW3,461 X multiple 36.0x
- 3) Target price range:
KRW143,000 ~ KRW93,400
- 4) Target price valuation:
2019E PER of 91x

OR composition (2019E, %)



Source: Company data, KB Securities

Earnings sensitivity analysis

(%)	EPS change	
	2018E	2019E
1% rise in FX Rate	+2.1	+2.1
1%p rise in interest rate	+0.4	+0.4

Peer group comparison

(KRWbn, X, %)	Market cap.	PER		PBR		EV/EBITDA		ROE		Dividend Yield	
		2019E	2020E	2019E	2020E	2019E	2020E	2019E	2020E	2019E	2020E
Jcontentree	714	30.3	22.9	2.7	2.4	10.8	9.0	10.8	12.2	n/a	n/a
Netflix	173,040	109.4	76.7	30.7	21.2	80.0	51.2	25.7	28.3	0.0	0.0
Zhejiang Huace Film&TV	2,026	15.9	12.6	1.6	1.4	14.1	11.3	10.0	11.8	0.6	0.8
Beijing HualuBaina Film&TV	667	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: Bloomberg, KB Securities

Table 1. Studio Dragon's 4Q18 consolidated earnings review

(KRWon, %, %p)	4Q18P	3Q18	QoQ	4Q17	YoY	KB estimates	Diff.	Consensus	Diff.
OR	101.7	123.7	(17.7)	71.9	41.5	102.5	(0.7)	103.2	(1.4)
OP	0.4	21.5	(97.9)	3.5	(87.3)	11.2	(96.1)	11.8	(96.3)
<i>OP margin</i>	<i>0.4</i>	<i>17.4</i>	<i>(16.9)</i>	<i>4.8</i>	<i>(4.4)</i>	<i>11.0</i>	<i>(10.5)</i>	<i>11.5</i>	<i>(11.0)</i>
NP to parent	1.7	17.3	(89.9)	2.0	(12.5)	9.3	(81.2)	10.9	(84.0)
<i>NP margin</i>	<i>1.7</i>	<i>14.0</i>	<i>(12.2)</i>	<i>2.8</i>	<i>(1.1)</i>	<i>9.1</i>	<i>(7.4)</i>	<i>10.6</i>	<i>(8.9)</i>

Source: FnGuide, KB Securities estimates

Table 2. Studio Dragon's consolidated earnings trend and estimates

(KRWbn)	1Q18	2Q18	3Q18	4Q18P	1Q19E	2Q19E	3Q19E	4Q19E	2017	2018P	2019E	2020E
OR	79.9	74.3	123.7	101.7	95.6	140.1	118.3	129.3	286.8	379.5	483.3	594.8
(QoQ %)	11.1	(7.0)	66.5	(17.7)	(6.0)	46.6	(15.6)	9.4	-	-	-	-
(YoY %)	6.0	19.6	59.6	41.5	19.7	88.6	(4.4)	27.1	46.7	32.3	27.3	23.1
Programming	40.7	34.1	48.9	54.4	44.9	58.2	61.8	69.7	131.2	178.1	234.6	283.1
Distribution	32.1	28.8	63.4	37.8	41.4	69.8	44.4	49.1	111.8	162.1	204.6	264.0
Others	7.1	11.4	11.4	9.5	9.3	12.1	12.1	10.5	43.7	39.4	44.1	47.7
OP	10.7	7.3	21.5	0.4	18.5	28.1	22.8	21.6	33.0	39.9	91.0	124.8
(QoQ %)	207.1	(31.3)	193.5	(97.9)	4,099.5	51.6	(18.8)	(5.1)	-	-	-	-
(YoY %)	(23.7)	(17.7)	223.0	(87.3)	73.8	283.7	6.2	4,805.4	55.6	21.0	128.2	37.1
<i>OP margin (%)</i>	<i>13.3</i>	<i>9.9</i>	<i>17.4</i>	<i>0.4</i>	<i>19.4</i>	<i>20.0</i>	<i>19.3</i>	<i>16.7</i>	<i>11.5</i>	<i>10.5</i>	<i>18.8</i>	<i>21.0</i>
NP to parent	7.9	8.9	17.3	1.7	14.5	21.6	17.8	17.0	23.8	35.7	70.9	97.1
(QoQ %)	293.5	13.0	94.2	(89.9)	728.7	49.4	(17.8)	(4.5)	-	-	-	-
(YoY %)	(41.3)	217.2	204.6	(12.5)	84.2	143.4	3.1	872.3	-	49.9	98.3	37.0
<i>NP margin (%)</i>	<i>9.8</i>	<i>12.0</i>	<i>14.0</i>	<i>1.7</i>	<i>15.1</i>	<i>15.4</i>	<i>15.0</i>	<i>13.1</i>	<i>8.3</i>	<i>9.4</i>	<i>14.7</i>	<i>16.3</i>

Source: Company data, KB Securities estimates

Table 3. Comparison of revised earnings estimates

(KRWbn, %, %p)	2018E					2019E				
	Changed	Previous	Diff.	Cons.	Diff.	Changed	Previous	Diff.	Cons.	Diff.
OR	379.5	380.3	(0.2)	381.5	(0.5)	483.3	491.0	(1.6)	506.3	(4.5)
OP	39.9	50.7	(21.3)	52.5	(23.9)	91.0	94.9	(4.1)	92.9	(2.0)
<i>OP margin</i>	<i>10.5</i>	<i>13.3</i>	<i>(2.8)</i>	<i>13.7</i>	<i>(3.2)</i>	<i>18.8</i>	<i>19.3</i>	<i>(0.5)</i>	<i>18.3</i>	<i>0.5</i>
NP to parent	35.7	43.3	(17.5)	44.5	(19.7)	70.9	77.1	(8.0)	75.3	(5.9)
<i>NP margin</i>	<i>9.4</i>	<i>11.4</i>	<i>(2.0)</i>	<i>11.7</i>	<i>(2.3)</i>	<i>14.7</i>	<i>15.7</i>	<i>(1.0)</i>	<i>14.9</i>	<i>(0.2)</i>

Source: FnGuide, KB Securities estimates

Profit & Loss					
(KRWbn)	2017A	2018E	2019E	2020E	2021E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	287	380	483	595	717
Cost of sales	240	324	374	448	533
Gross profit	47	56	110	147	184
SG&A expenses	14	16	19	22	25
Operating profit	33	40	91	125	158
EBITDA	74	108	141	149	170
Non-operating accounts	-3	6	5	6	8
Interest income	1	4	5	6	8
Interest expenses	2	0	1	1	1
Profit on equity method	0	0	0	0	0
Net other non-operating income	0	0	1	1	1
Profit before tax	30	46	96	131	167
Income tax expense	6	10	25	34	43
Net profit	24	36	71	97	124
NP to parent	24	36	71	97	124
Adj. net profit	24	36	71	97	124

Operating Statistics & Ratios					
(%)	2017A	2018E	2019E	2020E	2021E
OR growth	85.7	32.4	27.3	23.1	20.5
OP growth	98.3	21.0	128.2	37.1	27.0
EBITDA growth	91.4	46.0	29.8	5.6	14.6
NP growth of parent	193.0	50.3	97.7	37.0	27.2
GP margin	16.4	14.6	22.7	24.7	25.7
OP margin	11.5	10.5	18.8	21.0	22.1
EBITDA margin	25.9	28.6	29.1	25.0	23.8
EBT margin	10.6	12.0	19.8	22.1	23.3
NP margin	8.3	9.4	14.7	16.3	17.2

Cash Flow					
(KRWbn)	2017A	2018E	2019E	2020E	2021E
Cash flow from operating activities	-7	2	128	129	145
Net profit	24	36	71	97	124
Depreciation & amortization	41	69	50	24	12
Other non-cash adjustments	5	8	25	34	43
Investments in working capital	-73	-101	7	8	10
Decrease(Increase) in Receivables	-14	-38	-3	-3	-3
Decrease(Increase) in Inventories	-2	0	0	0	0
Increase(Decrease) in Payables	9	19	2	2	2
Other operating cash flow	20	-9	-25	-34	-43
Cash flow from investing activities	-141	1	-15	-16	-18
Capital expenditure	0	-1	-1	-1	-1
Investments in intangibles	0	0	-1	-1	-1
Changes in investment assets	-1	-1	0	0	0
Other investment cash flow	0	1	-7	-8	-9
Cash flow from financing activities	188	-10	0	0	0
Proceeds from (repayments of) debt	-18	-10	0	0	0
Changes in equity	208	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flow	-2	0	0	0	0
Other cash flow	0	0	0	0	0
Increase/decrease in cash	40	-7	113	113	128
Cash and cash equivalents at FYE	51	45	157	270	398
Free cash flow	-7	2	127	128	144
Net cash flow	199	2	118	119	134
Net cash (net debt)	182	184	302	421	555

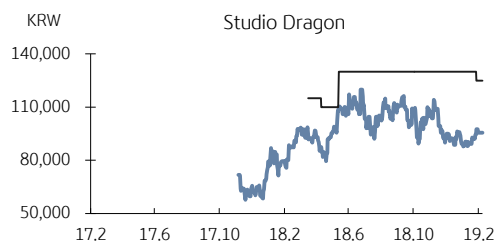
Source: Studio Dragon, KB Securities estimates

Statement of financial position					
(KRWbn)	2017A	2018E	2019E	2020E	2021E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Total assets	459	496	578	687	825
Current assets	290	278	400	523	661
Cash and cash equivalents	51	45	157	270	398
Current financial assets	141	139	145	151	157
Trade receivables	55	74	77	80	83
Inventories	1	2	2	2	2
Other current assets	41	19	19	20	21
Non-current assets	170	217	177	164	163
Investment assets	4	4	5	5	5
Property, plant and equipment	1	1	2	3	4
Intangible assets	128	153	105	82	72
Other non-current assets	36	56	63	71	80
Total liabilities	91	94	105	117	131
Current liabilities	91	87	98	111	124
Trade payables	6	14	15	17	20
Short-term financial liabilities	10	0	0	0	0
Other current liabilities	75	74	83	93	105
Non-current liabilities	0	6	7	7	7
Non-current financial liabilities	0	0	0	0	0
Other non-current liabilities	0	5	6	6	6
Total equity	368	402	473	570	693
Issued capital	14	14	14	14	14
Share premium	320	320	320	320	320
Other equity interest	3	0	0	0	0
Accumulated other comprehensive income	0	0	0	0	0
Retained earnings	32	68	139	236	359
Equity attributable to owners of parent	368	402	473	570	693
Non-controlling Interests	0	0	0	0	0

Key Ratio					
(X, %, KRW)	2017A	2018E	2019E	2020E	2021E
Multiples					
PER	61.9	72.3	37.4	27.3	21.5
PBR	4.9	6.4	5.6	4.7	3.8
PSR	5.1	6.8	5.5	4.5	3.7
EV/EBITDA	22.1	22.2	16.7	15.0	12.3
EV/EBIT	49.7	60.4	25.8	17.9	13.2
Dividend yield, ordinary (%)	NA	0.0	0.0	0.0	0.0
EPS	1,050	1,278	2,526	3,461	4,402
BPS	13,141	14,328	16,855	20,316	24,719
SPS	12,628	13,537	17,229	21,203	25,547
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	9.5	9.3	16.2	18.6	19.6
ROA	6.8	7.5	13.2	15.4	16.3
ROIC	15.6	16.0	35.7	60.1	85.5
Financial structure (%)					
Total liab./equity	24.7	23.3	22.2	20.6	19.0
Net debt/equity	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Current Ratio	3.2	3.2	4.1	4.7	5.3
Interest coverage (x)	19.0	233.2	75.9	104.0	132.1
Activity ratios					
Asset turnover (x)	0.8	0.8	0.9	0.9	1.0
Receivables turnover (x)	6.2	5.9	6.4	7.6	8.8
Inventory turnover (x)	0.0	236.7	252.7	311.0	374.7

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	-18.37	-7.85
18-12-01	6 month later	130,000	-28.13	-16.08
19-02-15	Buy	125,000		

KB Securities has not provided in advance the material contained in this report to any institutional investor or third party. The analyst(s), who wrote this report, does not have any financial interest in the company(ies) covered herein. The author(s) of this report confirms that the material contained herein correctly represents his/her/their opinion and that it has been prepared faithfully without any undue influence or intervention.

Proportion of investment rating (as of December 31, 2018)

Buy	Hold	Sell
70.6	29.4	-

* 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
---------------------	----------------------------	----------------------

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

All KB Securities Research is available via the following electronic databases: Bloomberg, Thomson Reuters, FactSet. Contact your KB Securities sales representative for access.

This report has been prepared for informational purposes only, and does not constitute an offer or solicitation of a contract for trading. Opinions in this report reflect professional judgment at this date based on information and data obtained from sources KB Securities considers reliable. However, KB Securities does not guarantee that the information and data are accurate or complete, and, therefore, this report is subject to change without prior notice. Individual investments should be made based on each client's own judgment and we expressly disclaim all liability for any investment decisions and any results thereof. This report is a copyrighted material of KB Securities and, thus, it may not be reproduced, distributed, or modified without the prior consent of KB Securities. This report is not prepared for academic purposes and any third party wishing to quote from it for academic publications should receive the prior consent of KB Securities.