

# Studio Dragon (253450.KQ)

## Singapore/Hong Kong NDR review: Asadal Chronicles to beef up earnings

Company Note | Mar 4, 2019

Starting with Asadal Chronicles (the firm's first multi-season tent-pole drama), Studio Dragon is to employ an OIMU strategy aimed at expanding its business arenas. Margins for Asadal Chronicles should improve in earnest from Season 2. Also warranting attention are: 1) collaborations with global players (Netflix, Chinese OTT firms); and 2) CJ E&M (largest shareholder)'s planned disposal of a stake in Studio Dragon.

### Foreign investors expressing strong interest in Asadal Chronicles

Over Feb 25~28, we conducted a NDR for Studio Dragon with foreign institutional investors in Singapore and Hong Kong. The attendees mainly focused on: 1) future business plans; 2) global collaborations with Netflix and Chinese OTT players; 3) CJ E&M (largest shareholder)'s planned disposal of a stake in Studio Dragon; and 4) Studio Dragon's depreciation method for intangible assets. The investors positively responded to the company's long-term business direction and its conservative cost recognition method.

The attendees' largest area of interest was Asadal Chronicles, Studio Dragon's first multiple seasonal tent-pole drama. Starting with Asadal Chronicles (the firm's first multi-season tent-pole drama), Studio Dragon is to employ a One IP Multi Use (OIMU) strategy aimed at expanding its business arenas to encompass games, tours, and other ventures—the company is nicknaming this new business model 'Studio Dragon 2.0'. We note that pre-distribution negotiations are already underway with a global OTT before its planned airing (2Q19). BEP for the project should be achievable even though fixed costs (such as set-up expenses) are to concentrate in Season 1 (as is the general case for multi-season dramas). But, from Season 2 (2020), margins should improve in earnest in line with: 1) operating leverage (on reduced fixed costs thanks to reuse of production assets set up for Season 1); and 2) the start of other income from IP utilization (including games and tours).

### Focus on: 1) collaborations with global OTT firms; and 2) CJ E&M's planned stake sale

Global collaborations: Two Netflix originals (Love Alarm and Holo) produced by Studio Dragon are to be released in 2H19. The firm is also expected to crystallize its plans for co-production of three dramas (My Mister, What's Wrong with Secretary Kim?, and 100 Days My Prince) with a Chinese player within 1H19.

Disposal of largest shareholder's stake: CJ E&M (largest shareholder)'s planned disposal of a stake (likely around 20%) in Studio Dragon should be finalized within 1H19. Studio Dragon is aiming to select strategic investors (SIs) in order to accelerate its global advancement via synergies on the production side.

## Buy (maintain)

TP **W135,000 (maintain)**  
CP (19/02/28) **W94,100**

<b>Sector</b>	<b>Entertainment</b>
Kospi/Kosdaq	2,195.44 / 731.25
Market cap (common)	US\$2,346.52mn
Outstanding shares (common)	28.1mn
52W high ('18/07/12)	W119,800
low ('18/05/08)	W79,600
Average trading value (60D)	US\$15.56mn
Dividend yield (2018E)	0.00%
Foreign ownership	2.8%
<b>Major Shareholders</b>	
CJENM & 3 others	74.4%

Share perf	3M	6M	12M	
Absolute (%)	-16.9	-14.1	7.3	
Relative (%p)	-20.4	-6.2	25.8	
	2017	2018E	2019F	2020F
Sales	286.8	379.5	515.0	599.6
Chg	85.8	32.3	35.7	16.4
OP	33.0	39.8	76.8	111.0
OPM	11.5	10.5	14.9	18.5
NP	23.8	35.8	63.9	90.5
EPS	1,050	1,277	2,277	3,226
Chg	84.5	21.6	78.3	41.7
P/E	61.9	72.4	41.3	29.2
P/B	4.9	6.4	5.6	4.7
EV/EBITDA	22.1	21.3	13.5	11.5
ROE	9.5	9.3	14.6	17.6
Debt/equity	24.7	21.0	19.0	16.7
Net debt	-182.2	-174.5	-222.3	-301.5

Unit: Wbn, %, won, x

Note 1: NP excludes minority interests

Note 2: EPS, P/E, P/B, and ROE based on NP (excl minority interests)

Source: NH I&S Research Center estimates



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### Building foothold: To be beneficiary of global OTT industry growth

Benefiting from intensifying competition between global OTT players, Studio Dragon is now beginning to pave the way towards reaping solid profit figures. Adhering to a Buy rating, we continue to suggest the company as our sector top pick.

Going forward, we suggest that investors concentrate on: 1) Studio Dragon's production of multi-season dramas such as Asadal Chronicles and Love Alarm; and 2) the firm's strengthened global influence thanks to both the securing of SIs and co-productions with global partners. In detail, as it is important for OTT companies to maintain subscriber bases, multi-season drama series tend to be more valuable than mini-series. Meanwhile, Studio Dragon's cooperation with global partners should translate into its contents being greater distributed over a more diverse range of countries. Given these positives, we believe now is the time to look at the firm's long-term potential rather than focus on its short-term profits.

### Studio Dragon 2.0: OIMU strategy to boost earnings

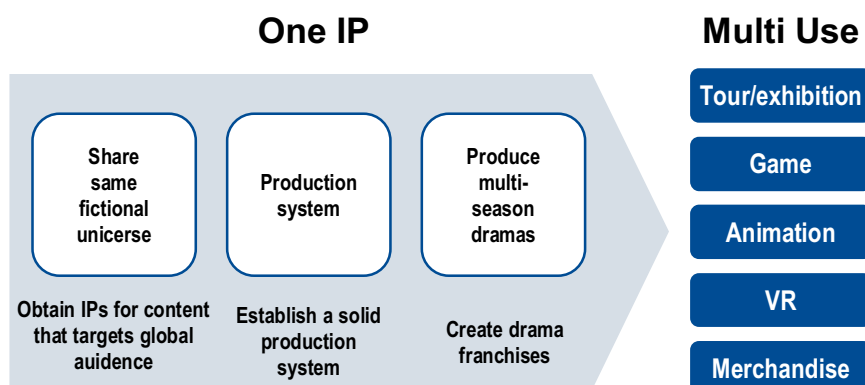
#### Studio Dragon 2.0

Foreign investors showed interest in Studio Dragon's business plans. The company plans to deploy a One IP Multi Use (OIMU) strategy aimed at expanding its business arenas to encompass games, tours, and other ventures—it is nicknaming this new business model Studio Dragon 2.0. Based on its IPs from original creative works of fiction, the company intends to create a collection of multi-season dramas and derivative works (eg, games) that share the same fictional universe. Such a strategy has proven successful for both various Marvel IPs-based series and HBO's Game of Thrones.

#### From Asdal Chronicles Season 2, margins to improve in earnest in line with revenue from derivative works

Asdal Chronicles is to mark the first drama series produced under Studio Dragon's OIMU strategy. Season 1 is to air in 2Q19, and Season 2 should follow in 2020. And, discussions are underway to produce games and animated features that share the same fictional universe with the drama series. There are plans to make the drama filming site in Osan open to tourists. BEP is to be achievable from Season 1. From Season 2, margins should improve in earnest in line with revenue from derivative works.

#### Studio Dragon 2.0



Source: Studio Dragon, NH I&S Research Center

### Asdal Chronicles cast: JG Song, JW Kim, DG Chang



Source: Media reports, NH I&S Research Center

### Concept images from Asdal Chronicles to be used in games and animated features



Source: Media reports, NH I&S Research Center

### Asdal Chronicles filming site in Osan



Source: Osan City blog, NH I&S Research Center

### House-raising ceremony in Osan



Source: Media reports, NH I&S Research Center

**Production cost per episode for Asadal project estimated to exceed W2.0bn**

Overall production costs for Asadal Chronicles Season 1 are sized at W40bn. In 2018, Studio Dragon inked contracts for the series with Samhwa Networks for set construction (W10bn) and scenic design (W4.8bn), and with Dexter Studios for visual effects (VFX; W8.4bn). Even not including expenses for the hiring of actors and crew, W23.2bn has been already budgeted. Moreover, expenses related to filming the drama in Brunei need to be taken into account as well. Given that VFX-related costs generally represent around 10~20% of the overall production expenses for a film production, we estimate that production cost per episode for Asadal Chronicles will exceed W2.0bn.

**However, BEP to be achievable from season 1**

It appears that broadcasting revenue will recover only a portion of Studio Dragon's hefty production costs. And, with the drama set in the ancient city of Asadal, product placement revenue is to be limited. Overall, we estimate that broadcasting revenue will cover about 50% of production costs. But, we note that pre-distribution negotiations are already underway with a global OTT. Studio Dragon's distribution contracts with Netflix last year averaged at 60% of related overall drama production costs, with a premium being rendered for tent-pole dramas. As for the Asadal project, while believing that drama set construction costs (W10bn) will be excluded from the anticipated distribution contract with the global OTT, we still estimate that the contract will be set at about 50% of the total production expenditure (W40bn). Thus, should the contract with global OTT be pulled through successfully, BEP should be achievable even from Season 1.

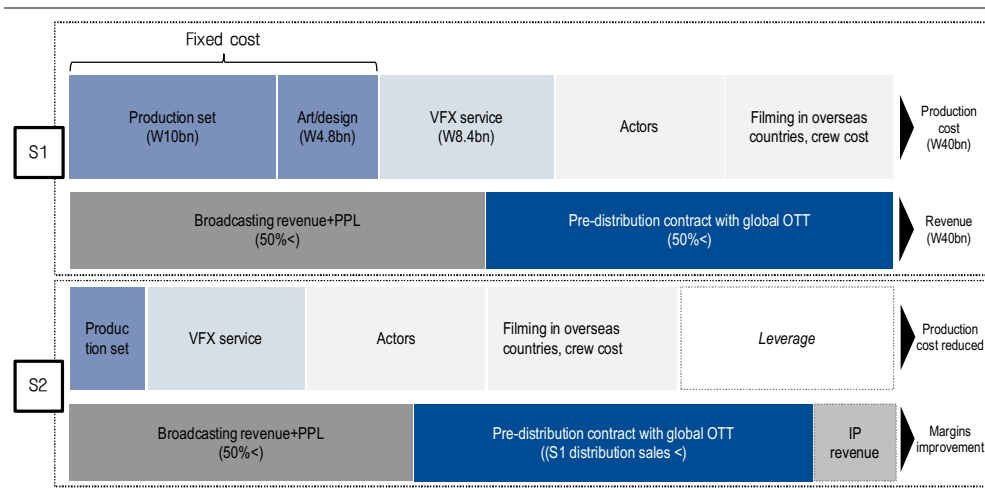
**Multi-season dramas are generally in red during the inaugural season**

Even in the US where multiple seasonal dramas are the norm, BEP tends to be reached only from Season 3. For instance, early seasons of the mega-hit drama series Game of Thrones generated only meager profits.

**Asadal Chronicles margins to improve sharply from Season 2**

In summary, BEP for the Asadal Chronicles project should be achievable even from Season 1 thanks to a differentiated profit structure based on the drama's global distribution model. Furthermore, from Season 2, margins for the drama should grow in earnest in line with: 1) greater operating leverage on reduced fixed costs (thanks to the reuse of production assets set up for Season 1); and 2) the start of income from IP utilization (including in games and merchandise). Moreover, we also note that as for a successful seasonal drama, the distribution sales tend to increase for later seasons.

**Asadal Chronicles: Expenses and revenue breakdown for Season 1 and Season 2**



Source: Dart, NH I&S Research Center estimates

## Earnings forecasts (IFRS-consolidated)

(Unit: Wbn, won, x, %)

		2017	2018P	2019E	2020F
Sales	- Revised	286.8	379.5	515.0	599.6
	- Previous	286.8	379.5	514.4	606.3
	- Change		0.0	0.1	-1.1
OP	- Revised	33.0	39.8	76.8	111.0
	- Previous	33.0	39.8	88.4	121.7
	- Change		0.0	-13.1	-8.8
OPM	- Revised	11.5	10.5	14.9	18.5
EBITDA		74.3	113.6	178.5	202.7
NP (excl minority interests)		23.8	35.8	63.9	90.5
EPS	- Revised	1,050	1,277	2,277	3,226
	- Previous		1,277	2,599	3,525
	- Change		0.0	-12.4	-8.5
P/E		61.9	72.4	41.3	29.2
P/B		4.9	6.4	5.6	4.7
EV/EBITDA		22.1	21.3	13.5	11.5
ROE		9.5	9.3	14.6	17.6

Note 1: EPS, P/E, P/B, and ROE based on NP (excluding minority interests)

Note 2: Intangible asset amortization figures raised from previous estimates; however, no changes in EBITDA

Source: NH I&amp;S Research Center estimates

## Earnings forecasts, by division

(Unit: episodes, Wbn, %)

	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18P	1Q19E	2Q19F	3Q19F	4Q19F	2017	2018E	2019F
Number of dramas	4	6	6	7	6	6	6	8	7	7	8	8	22	25	30
TV (domestic)	4	6	6	7	6	6	6	8	7	7	7	7	22	25	28
OTT	-	-	-	-	-	-	-	-	-	-	1	1	-	-	2
Sales	75.3	62.1	77.5	71.9	79.9	74.3	123.7	101.7	104.8	129.9	139.5	140.7	286.8	379.5	515.0
Broadcasting revenue	26.3	24.1	41.8	39.0	40.7	34.1	48.9	54.4	44.6	55.3	52.4	48.2	131.2	178.1	200.5
IP + VOD	36.5	26.3	23.3	25.7	32.1	28.8	63.4	37.8	49.0	59.7	74.0	80.0	111.8	162.1	262.7
Other (DVD, OST)	12.5	11.6	12.4	7.2	7.1	11.4	11.4	9.5	11.3	14.9	13.1	12.5	43.7	39.4	51.8
y-y (%)	-	-	-	-	6.0	19.6	59.7	41.5	31.3	74.8	12.8	38.4	46.7	32.3	35.7
COGS	58.6	49.9	66.8	64.4	66.2	63.7	98.9	95.2	86.1	109.9	112.9	114.5	239.7	324.0	423.4
Production costs	35.2	31.8	38.2	44.5	44.6	33.3	47.7	62.3	52.2	65.3	73.0	73.8	149.7	187.9	264.3
Amortization costs	9.9	9.8	10.3	10.9	12.7	13.1	23.3	24.4	20.6	29.5	25.2	26.1	41.0	73.5	101.5
Other	13.4	8.3	18.2	9.0	8.9	17.2	27.9	8.6	13.3	15.1	14.6	14.5	49.0	62.6	57.5
GP	16.8	12.2	10.7	7.4	13.6	10.6	24.8	6.5	18.7	20.0	26.6	26.3	47.1	55.5	91.6
GPM	22.2	19.6	13.9	10.4	17.1	14.3	20.1	6.4	17.9	15.4	19.1	18.7	16.4	14.6	17.8
OP	14.0	8.9	6.7	3.5	10.7	7.3	21.5	0.4	15.0	16.5	22.5	22.7	33.1	39.8	76.8
OPM	18.5	14.3	8.7	4.8	13.3	9.9	17.4	0.4	14.3	12.7	16.1	16.2	11.5	10.5	14.9
y-y (%)	-	-	-	-	-23.7	-17.6	218.5	-87.3	41.2	125.5	4.9	5,058.4	-	20.4	92.9
NP	13.4	2.8	5.7	2.0	7.9	8.9	17.3	1.7	11.9	15.8	18.0	18.2	23.8	35.8	63.9
NPM	17.8	4.5	7.3	2.8	9.8	12.0	14.0	1.7	11.3	12.2	12.9	12.9	8.3	9.4	12.4

Note: Number of dramas based on those aired in each quarter (If a drama is aired through two consecutive quarters, 0.5 is reflected in each quarter)

Source: NH I&amp;S Research Center estimates



## Studio Dragon's 2019 drama line-up

Title	Airing date	Quarter	Channel	Type	Highest viewership	Remarks
God's Quiz: Reboot (Season 5)	18.11.14~19.01.10	4Q, 1Q	OCN	16 episodes	2.6%	All episodes supplied to Netflix
Priest	18.11.24~19.01.20	4Q, 1Q	OCN	16 episodes	2.4%	
Eunjo's Room	18.11.06~19.01.22	4Q, 1Q	Olive	12 episodes	0.6%	Second season possible
Encounter	18.11.24~18.01.17	4Q, 1Q	tvN	16 episodes	10.0%	Export to more than 100 countries
Memories of the Alhambra	18.12.01~18.01.20	4Q, 1Q	tvN	16 episodes	9.7%	<b>[Tent-pole]</b> Supplied to Netflix Exported to China
The Man Who Became a King	19.01.07~19.02.26	1Q	tvN	16 episodes	10.1%	
Touch Your Heart	19.01.23~19.03.14	1Q	tvN	16 episodes	4.7%	
Romance is a Bonus Book	<b>19.01.26~19.03.17</b>	1Q	tvN	16 episodes	<b>5.8%</b>	Globally aired on Netflix
Possessed	19.03.06~19.04.25	1Q, 2Q	OCN	16 episodes		
Kill it	19.03.16~19.04.21	1Q, 2Q	OCN	12 episodes		
He Is Psychometric	19.03.11~19.04.30	1Q, 2Q	tvN	16 episodes		
Confession	19.03.23~19.05.12	1Q, 2Q	tvN	16 episodes		
Her Private Life		2Q	tvN	16 episodes		
Voice 3		2Q	OCN	16 episodes		
Watcher		2Q	OCN	16 episodes		
The Chronicles of Asdal		2Q	tvN	18 episodes		<b>[Tent-pole]</b> To be sold to global OTT
Spring Night		2Q, 3Q	MBC	16 episodes		Terrestrial broadcasting
Abyss		2Q, 3Q	tvN	16 episodes		
Save Me 2		2Q, 3Q	OCN	16 episodes		
Love Alarm S1		<b>3Q</b>	<b>Netflix</b>	<b>8 episodes</b>		<b>Based on popular webtoon series</b>
Man Who Bakes Bread		3Q	tvN	16 episodes		
Everyone's Privacy		3Q	tvN	16 episodes		
Doctor Room		3Q	SBS	16 episodes		Terrestrial broadcasting
When the Devil Calls Your Name		3Q	tvN	16 episodes		
Hotel del Luna		3Q	tvN	16 episodes		<b>[Tent-pole]</b>
Designated Survivor		3Q, 4Q	tvN	16 episodes		Drama remake
I am Alone S1		<b>4Q</b>	<b>Netflix</b>	<b>12~15 episodes</b>		

Note: Media report, Studio Dragon, NH I&amp;S Research Center estimates

STATEMENT OF COMPREHENSIVE INCOME				
(Wbn)	2017/12A	2018/12E	2019/12F	2020/12F
<b>Sales</b>	<b>286.8</b>	<b>379.5</b>	<b>515.0</b>	<b>599.6</b>
Growth (%)	85.8	32.3	35.7	16.4
<b>COGS</b>	<b>239.7</b>	<b>324.0</b>	<b>423.4</b>	<b>470.7</b>
<b>Gross Profit</b>	<b>47.1</b>	<b>55.5</b>	<b>91.6</b>	<b>128.9</b>
Gross margin (%)	16.4	14.6	17.8	21.5
SG&A	14.2	15.7	14.8	18.0
<b>Operating Income</b>	<b>33.0</b>	<b>39.8</b>	<b>76.8</b>	<b>111.0</b>
Growth (%)	98.8	20.6	93.0	44.5
Operating margin (%)	11.5	10.5	14.9	18.5
<b>EBITDA</b>	<b>74.3</b>	<b>113.6</b>	<b>178.5</b>	<b>202.7</b>
<b>Non-Operating Profit</b>	<b>-2.7</b>	<b>5.1</b>	<b>5.0</b>	<b>5.1</b>
Financial Income(Costs)	-2.5	0.6	1.1	1.5
Other Non-Operating Profit	-0.2	0.0	0.0	0.0
Gains(Losses) in Associates, Subsidiaries and JVs	0.0	4.5	3.9	3.6
<b>Pre-tax Profit from Cont. Op.</b>	<b>30.3</b>	<b>45.7</b>	<b>81.9</b>	<b>116.0</b>
<b>Income Taxes</b>	<b>6.4</b>	<b>9.9</b>	<b>18.0</b>	<b>25.5</b>
Profit from Continuing Op.	23.8	35.8	63.9	90.5
<b>Net Profit</b>	<b>23.8</b>	<b>35.8</b>	<b>63.9</b>	<b>90.5</b>
Growth (%)	193.8	50.4	78.5	41.6
Net margin (%)	8.3	9.4	12.4	15.1
Net Profit of Parent	23.8	35.8	63.9	90.5
Net Profit to Non-Controlling	0.0	0.0	0.0	0.0
Other Comprehensive Income	-0.1	0.0	0.0	0.0
Total Comprehensive Income	23.8	35.8	63.9	90.5

Valuation / Profitability / Stability				
	2017/12A	2018/12E	2019/12F	2020/12F
Price/Earnings (x)	61.9	72.4	41.3	29.2
Price/Book Value (x)	4.9	6.4	5.6	4.7
Price/Gross Cash Flow (x)	21.2	21.8	14.5	12.8
Price/Sales (x)	5.1	6.8	5.1	4.4
EV/EBITDA (x)	22.1	21.3	13.5	11.5
EV/EBIT (x)	49.7	60.7	31.5	21.1
Fully diluted EPS (won)	1,050	1,277	2,277	3,226
BVPS (won)	13,141	14,411	16,687	19,913
Sales PS (won)	12,628	13,537	18,358	21,377
ROE (%)	9.5	9.3	14.6	17.6
ROA (%)	6.8	7.5	12.2	15.0
ROIC (%)	14.2	14.8	25.9	35.3
Dividend Yield (%)	0.0	0.0	0.0	0.0
Payout Ratio (%)	0.0	0.0	0.0	0.0
Total Cash Dividend (Wbn)	0.0	0.0	0.0	0.0
Cash DPS (won)	0	0	0	0
Net debt(cash)/ equity (%)	-49.4	-43.2	-47.5	-54.0
Debt/ equity (%)	24.7	21.0	19.0	16.7
Interest-Bearing Debts (Wbn)	10.0	0.0	0.0	0.0
Current Ratio (%)	319.6	327.1	370.4	441.7
Total shares (mn)	28	28	28	28
Par value (won)	500	500	500	500
Share price (won)	65,000	92,400	94,100	94,100
Market Cap (Wbn)	1,822	2,592	2,640	2,640

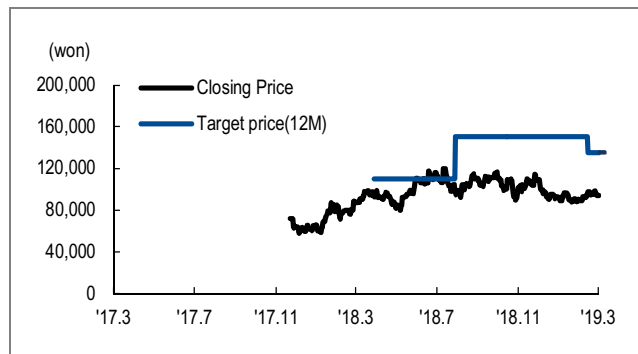
STATEMENT OF FINANCIAL POSITION				
(Wbn)	2017/12A	2018/12E	2019/12F	2020/12F
Cash and Cash Equivalents	51.3	26.6	67.0	138.5
Accounts Receivables	54.9	57.7	60.0	61.8
<b>Total Current Assets</b>	<b>289.8</b>	<b>276.2</b>	<b>327.7</b>	<b>410.1</b>
Tangible Assets	1.1	0.8	0.6	0.5
Investment Assets	3.8	4.3	4.4	4.5
<b>Non-Current Assets</b>	<b>169.6</b>	<b>212.9</b>	<b>229.4</b>	<b>242.0</b>
<b>Assets</b>	<b>459.5</b>	<b>489.1</b>	<b>557.1</b>	<b>652.1</b>
Short-Term Debt	10.0	0.0	0.0	0.0
Account Payables	6.1	6.1	6.2	6.4
<b>Current Liabilities</b>	<b>90.7</b>	<b>84.4</b>	<b>88.5</b>	<b>92.8</b>
Long-Term Debt	0.0	0.0	0.0	0.0
Long-Term Allowance	0.3	0.4	0.6	0.7
<b>Non-Current Liabilities</b>	<b>0.3</b>	<b>0.4</b>	<b>0.6</b>	<b>0.7</b>
<b>Liabilities</b>	<b>91.0</b>	<b>84.9</b>	<b>89.0</b>	<b>93.5</b>
Capital Stock	14.0	14.0	14.0	14.0
Capital Surplus	319.6	319.6	319.6	319.6
Retained Earnings	32.1	67.9	131.8	222.3
Non-Controlling Interests Equity	0.0	0.0	0.0	0.0
<b>Shareholders' Equity</b>	<b>368.4</b>	<b>404.2</b>	<b>468.1</b>	<b>558.6</b>

CASH FLOW STATEMENT				
(Wbn)	2017/12A	2018/12E	2019/12F	2020/12F
<b>Operating Cash Flow</b>	<b>-7.2</b>	<b>108.7</b>	<b>165.0</b>	<b>182.0</b>
Net Profit	23.8	35.8	63.9	90.5
Depreciation & Amortization	41.3	73.8	101.7	91.7
+ Loss(Gains) from Subs	0.0	0.0	0.0	0.0
+ FC translation loss(profit)	0.8	0.0	0.0	0.0
Gross Cash Flow	69.7	118.9	182.5	206.3
- Incr. (Decr.) in WC	-72.9	-0.2	0.5	1.3
<b>Investing Cash Flow</b>	<b>-141.0</b>	<b>-123.0</b>	<b>-124.5</b>	<b>-110.6</b>
+ Decr. In Tangible Assets	0.1	0.0	0.0	0.0
- Incr. In Tangible Assets (capex)	-0.1	0.0	0.0	0.0
+ Disp.(Acq.) of Inv. Assets	-1.5	-0.5	-0.1	-0.1
Free Cash Flow	-7.3	108.7	165.0	182.0
Net Cash Flow	-148.2	-14.3	40.5	71.4
<b>Financing Cash Flow</b>	<b>188.1</b>	<b>-10.4</b>	<b>0.0</b>	<b>0.0</b>
Equity Financing	207.8	0.0	0.0	0.0
Debt Financing	-19.7	-10.4	0.0	0.0
Incr.(Decr.) in Cash	39.8	-24.8	40.5	71.4
Ending Cash and Cash Equivalents	51.3	26.6	67.0	138.5
Net Debt (Cash)	-182.2	-174.5	-222.3	-301.5

## Rating and TP update

Date	Rating	TP	Disparity ratio (%)	
			Avg	Max/Min
2019.02.15	Buy	W135,000(12M)	-	-
2018.07.30	Buy	W150,000(12M)	-32.9%	-22.5%
2018.03.30	Buy	W110,000(12M)	-8.5%	8.9%

## Studio Dragon (253450.KQ)



## NH Investment &amp; Securities stock ratings

1. Rating based on a stock's forecasted absolute return over a period of 12 months from the date of publication.

- Buy: Greater than +15%
- Hold: -15% to +15%
- Sell: Less than -15%

2. Regarding listed companies under NH I&S' coverage, our stock ratings break down as follows (as of Mar 1, 2019).

● NH I&S' stock rating distribution

Buy	Hold	Sell
76.8%	23.2%	0.0%

- The stock rating on an individual company can change at irregular intervals. Our stock rating distribution is calculated on a weekly basis.

## Compliance notice

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- This report correctly reflects the analyst's opinion and was written without any external influence or intervention.

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