

# Studio Dragon (253450)

## Weak Earnings Anticipated in 1H19

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

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

**Retain BUY rating; Target price cut 4.0% to KRW120,000**

We retain our BUY rating on Studio Dragon, while cutting the target price 4.0% to KRW120,000. The target price was lowered as 2019 EPS estimates were revised down 7.1% and 2020 EPS lowered 2.7% to accommodate increases in amortization expenses arising from rising average production costs. Although 1Q19 results were rather disappointing, Studio Dragon remains in the spotlight due to the mounting hype over the blockbuster drama series, "Arthdal Chronicles," which is scheduled to air on Jun 1.

**1Q19 review: OR beats consensus, while OP falls short due to rise in production costs**

Studio Dragon turned in 1Q19 OR of KRW11.8bn (+40.0% YoY, +9.9% QoQ) and OP of KRW11.0bn (+3.5% YoY, +2,400.7% QoQ). OR came in 18.6% above market consensus, while OP fell 8.3% short. Programming revenues grew 8.4% YoY and distribution revenues rose 75.1% YoY. Programming revenues were hampered by a high base effect created by the tent-pole drama, "A Korean Odyssey," that aired in 1Q18. Meanwhile, the company's top-line received a hefty boost from distribution revenues, which achieved fast-paced growth on the back of overseas licensing deals for "Memories of the Alhambra," "Romance is a Bonus Book" and other blockbuster contents. COGS ratio came in at 86.6% (+3.7%p YoY) due to increased amortization expenses triggered by rising average production costs.

**"Arthdal Chronicles" to be flagship content generating revenues for next three years**

It will be worth paying keen attention on the performance of "Arthdal Chronicles," which aspires to be Korea's equivalent to "The Game of Thrones." Planned as a three-season series, "Arthdal Chronicles" is expected to break even during the first season. However, if it becomes a hit series, the IP has massive potential for growth. 1) Set construction expenses and other investments made during the first season will act as a form of fixed

## Buy maintain

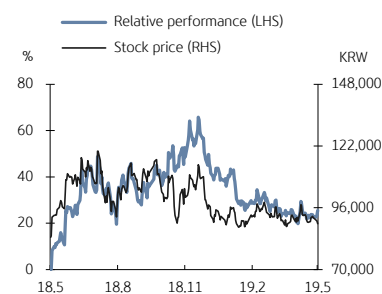
<b>Target Price (lowered)</b>	<b>KRW120,000</b>
Upside/Downside	34.4%
Current price (May 9)	KRW89,300
Consensus Target Price	KRW126,533
Market cap	USD2.1bn

Trading Data	
Free float	25.2%
Avg T/O Val (3M, KRWbn)	13.5
Foreign ownership	3.2%
Major shareholders	CJ E&M Corporation and 3 others 74.4%

Share price performance				
(%)	1M	3M	6M	12M
Absolute	-2.4	-3.0	-11.1	6.8
Relative	2.0	-2.4	-15.6	25.5

### Forecast earnings & valuation

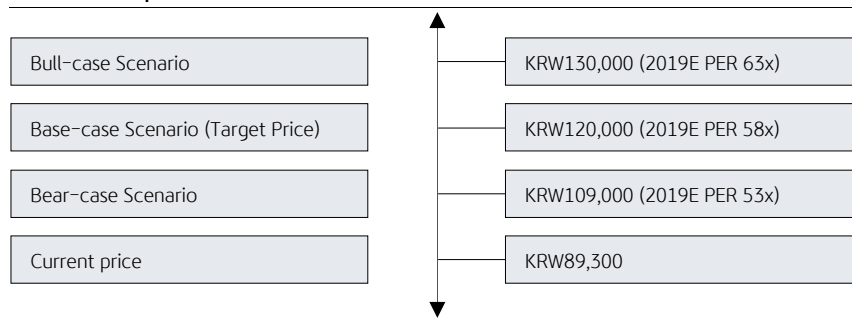
FY-end	2018A	2019E	2020E	2021E
OR (KRWbn)	380	491	586	695
OP (KRWbn)	40	70	119	149
NP to parent (KRWbn)	36	58	94	118
EPS (KRW)	1,278	2,063	3,364	4,224
EPS Growth (%)	21.7	61.4	63.1	25.6
PER (x)	72.3	43.3	26.5	21.1
EV/EBITDA (x)	21.2	15.9	13.6	11.7
PBR (x)	6.5	5.5	4.5	3.7
ROE (%)	9.3	13.5	18.6	19.3
Div. Yield (%)	NA	0.0	0.0	0.0



Source: Studio Dragon, KB Securities estimates

costs and result in cost cuts during future seasons. 2) The universe established through the series and the story may be applied to games, merchandise, VR contents and others. 3) If successful, the track record of successfully producing a multi-season series will fan hopes of Studio Dragon winning content orders from global content platform operators. In addition to anticipated revenues from China in 2H19, Studio Dragon is enjoying a sharp increase of distribution revenues from other overseas markets. The competitive edge of Studio Dragon's contents is expected to result in increases in distribution revenue and profit leverage in 2H19.

## Investment opinion and risks



## Base-case Scenario: Catalysts

- 1) Netflix original drama production volume increases
- 2) Viewership rate of drama "Arthdal Chronicles" increases

## Bull-case Scenario: Upside risks

- 1) Netflix original drama production volume soars
- 2) Viewership rate of drama "Arthdal Chronicles" soars

## Bear-case Scenario: Downside risks

- 1) Netflix original drama production volume decreases
- 2) Viewership rate of drama "Arthdal Chronicles" decreases

## Revised earnings estimates

(KRWbn, %)	Previous		Revised		Change	
	2019E	2020E	2019E	2020E	2019E	2020E
OR	482.4	580.6	491.4	586.3	1.9	1.0
OP	76.5	121.2	70.0	119.0	-8.5	-1.8
NP to parent	62.3	97.0	57.9	94.4	-7.1	-2.7

Source: KB Securities estimates

## KB estimate vs. Consensus

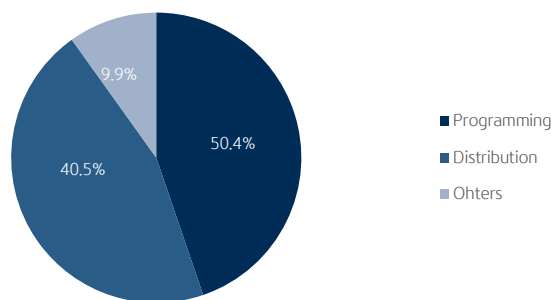
(KRWbn, %)	KB est.		Consensus		Difference	
	2019E	2020E	2019E	2020E	2019E	2020E
OR	491.4	586.3	476.5	570.2	3.1	2.8
OP	70.0	119.0	68.3	102.5	2.4	16.1
NP to parent	57.9	94.4	56.9	83.2	1.7	13.5

Source: Wisefn, KB Securities estimates

## Valuation and target price calculation

- 1) Valuation method:  
PER Valuation
- 2) Target price calculation:  
2020E EPS KRW3,346 X Multiple 36x
- 3) Target price range:  
KRW130,000 ~ KRW109,000
- 4) Valuation at target price:  
2019E PER 58x

## OR composition (2019E, %)



Source: Company data, KB Securities

## Earnings sensitivity analysis

(%)	EPS change	
	2019E	2020E
1) 1%p rise in interest rate	+2.0	+2.1
2) 1% rise in FX rate	+0.3	+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	820	35.1	28.3	3.0	2.5	11.8	9.3	10.6	10.3	n/a	n/a
Netflix	188,390	113.4	91.7	31.8	22.4	83.0	53.7	25.7	24.5	0.0	0.0
Zhejiang Huace Film&TV	2,000	46.2	16.9	1.6	1.4	16.7	14.7	7.6	9.6	0.4	0.6
Beijing HualuBaina Film&TV	776	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

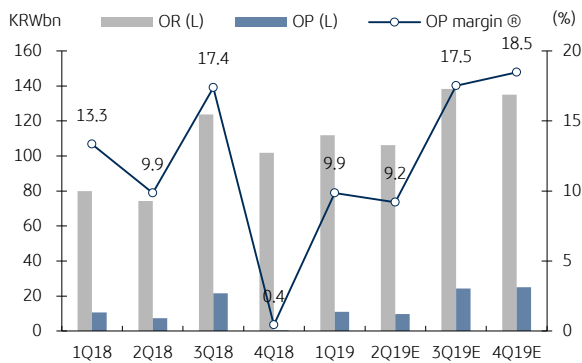
Source: Bloomberg, KB Securities

Table 1. Comparison of 1Q19 earnings and market consensus

(KRWon, %, %p)	1Q19P	4Q18	QoQ	1Q18	YoY	KB estimates	Diff.	Consensus	Diff.
OR	111.8	101.7	9.9	79.9	40.0	93.6	19.5	94.3	18.6
OP	11.0	0.4	2,400.7	10.7	3.5	11.5	(3.8)	12.0	(8.3)
OP margin	9.9	0.4	9.4	13.3	(3.5)	12.3	(2.4)	12.8	(2.9)
NP to parent	9.1	1.7	422.6	7.9	16.2	9.7	(6.0)	10.6	(13.7)
NP margin	8.2	1.7	6.4	9.8	(1.7)	10.4	(2.2)	11.2	(3.1)

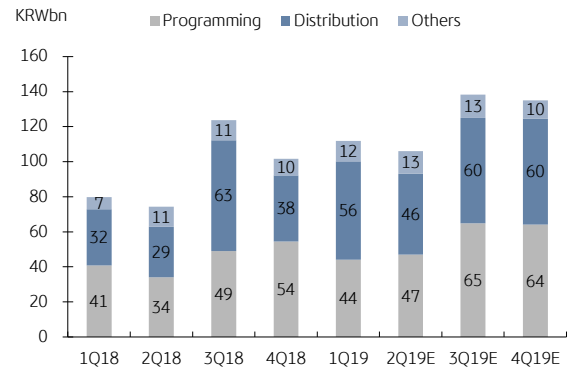
Source: FnGuide, KB Securities estimates

Fig 1. Earnings trend and forecast



Source: company data, KB securities estimates

Fig 2. Earnings composition trend



Source: company data, KB securities estimates

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

(KRWbn)	1Q18	2Q18	3Q18	4Q18	1Q19P	2Q19E	3Q19E	4Q19E	2017	2018	2019E	2020E
<b>OR</b>	79.9	74.3	123.7	101.7	111.8	106.1	138.5	135.1	286.8	379.5	491.4	586.3
(QoQ %)	11.1	(7.0)	66.5	(17.7)	9.9	(5.1)	30.3	(2.3)	-	-	-	-
(YoY %)	6.0	19.6	59.6	41.5	40.0	42.9	11.9	32.8	46.7	32.3	29.5	19.3
Programming	40.7	34.1	48.9	54.4	44.1	46.9	64.8	64.2	131.2	178.1	220.0	254.6
Distribution	32.1	28.8	63.4	37.8	56.2	46.1	60.2	60.4	111.8	162.1	222.9	275.2
Others	7.1	11.4	11.4	9.5	11.5	13.1	13.3	10.5	43.7	39.4	48.4	56.6
<b>OP</b>	10.7	7.3	21.5	0.4	11.0	9.8	24.2	25.0	33.0	39.9	70.0	119.0
(QoQ %)	207.1	(31.3)	193.5	(97.9)	2,400.7	(11.5)	148.3	3.0	-	-	-	-
(YoY %)	(23.7)	(17.7)	223.0	(87.3)	3.5	33.3	12.8	5,559.5	55.6	21.0	75.4	70.1
OP margin (%)	13.3	9.9	17.4	0.4	9.9	9.2	17.5	18.5	11.5	10.5	14.2	20.3
<b>NP to parent</b>	7.9	8.9	17.3	1.7	9.1	8.5	19.7	20.5	23.8	35.7	57.9	94.4
(QoQ %)	293.5	13.0	94.2	(89.9)	422.6	(6.4)	130.8	4.0	-	-	-	-
(YoY %)	(41.3)	217.2	204.6	(12.5)	16.2	(3.9)	14.3	1,073.4	-	49.9	61.9	63.0
NP margin (%)	9.8	12.0	14.0	1.7	8.2	8.0	14.3	15.2	8.3	9.4	11.8	16.1

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	491.4	482.4	1.9	476.5	3.1	586.3	580.6	1.0	570.2	2.8
OP	70.0	76.5	(8.5)	68.3	2.4	119.0	121.2	(1.8)	102.5	16.1
<i>OP margin</i>	<i>14.2</i>	<i>15.9</i>	<i>(1.6)</i>	<i>14.3</i>	<i>(0.1)</i>	<i>20.3</i>	<i>20.9</i>	<i>(0.6)</i>	<i>18.0</i>	<i>2.3</i>
NP to parent	57.9	62.3	(7.1)	56.9	1.7	94.4	97.0	(2.7)	83.2	13.5
<i>NP margin</i>	<i>11.8</i>	<i>12.9</i>	<i>(1.1)</i>	<i>11.9</i>	<i>(0.2)</i>	<i>16.1</i>	<i>16.7</i>	<i>(0.6)</i>	<i>14.6</i>	<i>1.5</i>

Source: Fnguide, KB Securities estimates

Profit & Loss					
(KRWbn)	2017A	2018A	2019E	2020E	2021E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	287	380	491	586	695
Cost of sales	240	324	402	446	521
Gross profit	47	56	89	141	174
SG&A expenses	14	16	19	22	25
Operating profit	33	40	70	119	149
EBITDA	74	115	139	154	167
Non-operating accounts	-3	6	7	5	7
Interest income	1	4	9	6	8
Interest expenses	2	0	2	1	1
Profit on equity method	0	0	0	0	0
Net other non-operating income	0	0	0	0	0
Profit before tax	30	46	77	124	156
Income tax expense	6	10	19	30	37
Net profit	24	36	58	94	118
NP to parent	24	36	58	94	118
Adj. net profit	24	36	58	94	118

Operating Statistics & Ratios					
(%)	2017A	2018A	2019E	2020E	2021E
OR growth	85.7	32.4	29.4	19.3	18.5
OP growth	98.3	21.0	75.4	70.1	25.1
EBITDA growth	91.4	55.1	21.1	10.7	8.3
NP growth of parent	193.0	50.2	61.5	63.0	25.6
GP margin	16.4	14.6	18.1	24.0	25.0
OP margin	11.5	10.5	14.2	20.3	21.4
EBITDA margin	25.9	30.3	28.4	26.3	24.1
EBT margin	10.6	12.0	15.7	21.2	22.4
NP margin	8.3	9.4	11.8	16.1	17.1

Cash Flow					
(KRWbn)	2017A	2018A	2019E	2020E	2021E
Cash flow from operating activities	-7	-29	137	141	150
Net profit	24	36	58	94	118
Depreciation & amortization	41	75	69	35	18
Other non-cash adjustments	5	-1	19	30	37
Investments in working capital	-73	-139	10	11	13
Decrease(Increase) in Receivables	-14	-27	-3	-3	-3
Decrease(Increase) in Inventories	-2	0	0	0	0
Increase(Decrease) in Payables	9	26	2	3	3
Other operating cash flow	20	36	-19	-30	-37
Cash flow from investing activities	-141	141	-9	-10	-11
Capital expenditure	0	0	-1	-1	-1
Investments in intangibles	0	0	-1	-1	-1
Changes in investment assets	-141	138	0	0	0
Other investment cash flow	0	3	-7	-8	-8
Cash flow from financing activities	188	-10	33	537	429
Proceeds from (repayments of) debt	-18	-10	33	537	429
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	102	161	668	567
Cash and cash equivalents at FYE	51	153	314	982	1,549
Free cash flow	-7	-29	136	140	149
Net cash flow	199	-29	128	131	139
Net cash (net debt)	183	153	281	412	551

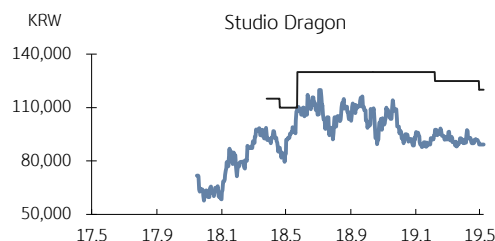
Statement of financial position					
(KRWbn)	2017A	2018A	2019E	2020E	2021E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Total assets	459	512	617	1,263	1,828
Current assets	290	247	412	1,084	1,655
Cash and cash equivalents	51	153	314	982	1,549
Current financial assets	141	2	3	3	3
Trade receivables	55	69	72	74	77
Inventories	1	1	1	1	1
Other current assets	41	22	23	24	25
Non-current assets	170	265	205	180	172
Investment assets	4	4	4	4	4
Property, plant and equipment	1	1	2	3	4
Intangible assets	128	199	131	97	80
Other non-current assets	36	53	60	67	76
Total liabilities	91	111	158	710	1,156
Current liabilities	91	108	122	137	154
Trade payables	6	20	22	25	28
Short-term financial liabilities	10	0	0	0	0
Other current liabilities	75	89	100	112	126
Non-current liabilities	0	3	36	573	1,001
Non-current financial liabilities	0	2	35	572	1,001
Other non-current liabilities	0	0	0	0	0
Total equity	368	401	459	554	672
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	-1	-1	-1	-1
Retained earnings	32	68	126	220	338
Equity attributable to owners of parent	368	401	459	554	672
Non-controlling Interests	0	0	0	0	0

Key Ratio					
(X, %, KRW)	2017A	2018A	2019E	2020E	2021E
Multiples					
PER	61.9	72.3	43.3	26.5	21.1
PBR	4.9	6.5	5.5	4.5	3.7
PSR	5.1	6.8	5.1	4.3	3.6
EV/EBITDA	22.1	21.2	15.9	13.6	11.7
EV/EBIT	49.7	61.1	31.8	17.6	13.1
Dividend yield, ordinary (%)	NA	NA	0.0	0.0	0.0
EPS	1,050	1,278	2,063	3,364	4,224
BPS	13,141	14,305	16,369	19,733	23,957
SPS	12,628	13,539	17,517	20,901	24,765
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	13.5	18.6	19.3
ROA	6.8	7.4	10.3	10.0	7.7
ROIC	15.6	15.1	26.0	61.3	95.3
Financial structure (%)					
Total liab./equity	24.7	27.7	34.3	128.3	172.0
Net debt/equity	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Current Ratio	3.2	2.3	3.4	7.9	10.7
Interest coverage (x)	19.0	343.0	33.3	99.2	124.0
Activity ratios					
Asset turnover (x)	0.8	0.8	0.9	0.6	0.5
Receivables turnover (x)	6.2	6.1	7.0	8.0	9.1
Inventory turnover (x)	0.0	405.4	849.6	1,013.8	1,201.2

Source: Studio Dragon, KB Securities estimates

## 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	-25.98	-21.36
19-05-09	Buy	120,000		

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## Proportion of investment rating (as of March 31, 2019)

Buy	Hold	Sell
71.9	28.1	-

\* 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
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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

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